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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1471

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.),
Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

This is an action under the Securities Exchange Act of 1934 ("1934 Act") and related rules of the Securities and Exchange Commission ("SEC").

Petitioners (hereinafter "TSC" or "National") request that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit (Chief Judge Swygert) reversing, on interlocutory appeal pursuant to 28 U. S. C. §1292(b), the denial by the United States District Court for the Northern District of Illinois (Judge Richard W. McLaren) of Respondent's motion for partial summary judg-

ment as to the liability of Petitioners. The other defendants, known collectively as the Schmidt defendants, have no interest in the outcome of this petition.

OPINIONS BELOW.

The opinion of the Court of Appeals has not been reported as of this time (A1-30).* Judge McLaren's Memorandum Opinion and Order of May 21, 1973, denying partial summary judgment as to the liability of Petitioners TSC and National, is reported at 361 F. Supp. 108 (A31-45). Judge McLaren's Memorandum Opinion and Order of August 10, 1973, amending the foregoing Order of May 21, 1973, is unreported (A46-48).

JURISDICTION.

The judgment of the Court of Appeals for the Seventh Circuit was entered March 5, 1975 (A1). This Court's jurisdiction is invoked under 28 U. S. C. §1254(1).

QUESTIONS PRESENTED FOR REVIEW.

1. Whether "materiality", under the federal securities laws' prohibition against materially false or misleading statements or omissions, requires only a showing of relevancy and possible importance to "some few stockholders," as the Seventh Circuit held, or whether it requires a stronger showing of "significant propensity" to affect shareholders' judgment as this Court stated in *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970).

2. Whether the Seventh Circuit misused summary judgment, and hence improperly foreclosed TSC and National from a trial as to the issue of the materiality of the complained of omissions, by finding such omissions to be material as a matter of law?

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* All citations herein to "A" refer to the Appendix, *infra*, to this Petition. References to the separate four volume Joint Appendix in the Court of Appeals, which will be filed with the Clerk, are cited by volume number as "Vol."

STATUTES AND RULES INVOLVED.

Securities Exchange Act of 1934, § 14(a), 15 U. S. C. §78n(a) (A49).

Securities and Exchange Commission Rules 14a-9 and 405(a), (f), (n), 17 C. F. R. §§ 240.14a-9, 230.405(a), (f), (n) (A49-51).

Federal Rules of Civil Procedure, Rule 56(a), (b) and (c) (A51-52).

STATEMENT OF THE CASE.

This case arose out of the acquisition by National Industries, Inc. ("National"), a diversified company whose common shares are listed on the New York Stock Exchange, of substantially all of the assets of TSC Industries, Inc. ("TSC"), also a New York Stock Exchange listed company, which was engaged in the sale of repair and replacement parts for farm machinery and general retailing.

In February 1969, National purchased a substantial minority interest in TSC from Charles E. Schmidt, its founder. Including subsequent purchases, National's interest increased to approximately 34% of TSC's voting securities by October 1969. By that time five of the ten directors of TSC were National nominees. Shortly thereafter the Boards of Directors of both corporations approved, subject to shareholder approval, a transaction pursuant to which National acquired all of the assets of TSC in exchange for certain securities of National. Only those directors of TSC who were not nominated by National voted on the proposed transaction.

Respondent Northway, Inc. ("Plaintiff") is a corporation organized by an individual investor to hold his investments, including 200 shares of TSC. Plaintiff brought this derivative action pursuant to Section 27 of the Securities and Exchange Act of 1934 ("the 1934 Act") challenging the joint proxy statement

("Proxy Statement") furnished by TSC and National to their respective shareholders seeking approval of the proposed acquisition (Vol. III, Part 1, Ex. A to Complaint). Plaintiff claimed violations of various sections of the federal securities laws and related SEC Rules, including Rules 14a-9 and 10b-5 which forbid materially false or misleading statements or omissions.

Plaintiff moved for partial summary judgment before Judge McLaren against TSC and National on the issue of liability alone. The motion was based on the theory that certain omissions in the Proxy Statement were "material" as a matter of law and that consequently the Proxy Statement failed to comply with the disclosure requirements of the 1934 Act and the proxy rules issued thereunder. Plaintiff asserted that, among other things, the Proxy Statement was misleading in that it stated that the proposed sale of assets was approved by the Board of Directors of TSC without adequately disclosing facts regarding the relationship between TSC and National.

The Proxy Statement did, as Judge McLaren noted in his Opinion (A35, 37), "set forth under separate headings" at pages 6 and 7, (1) the approval of the sale to National by the TSC Board of Directors (such approval was by four disinterested members), (2) as well as the fact that National owned approximately 34% of the outstanding shares of TSC and (3) that five out of ten members of the TSC Board were National nominees (none of whom voted on the proposed sale).*

Pages 6 and 7 of the Proxy Statement are reproduced in full text at pp. 20-21 below as an exhibit to this petition. On these

* These headings, all appearing on page 6 of the Proxy Statement, read in equally-sized bold face type (p. 20 below):

BOARDS OF DIRECTORS APPROVAL

• • •

NATIONAL'S EQUITY INTEREST IN TSC

• • •

NATIONAL'S NOMINEES ON TSC'S BOARD

pages, all the essential facts as to National's interests in TSC were fully and prominently disclosed at the first point in the Proxy Statement where such disclosure was meaningful.

Plaintiff contended, however, that these disclosures were not adequate because the Proxy Statement did not disclose *in addition* (1) that National's president and executive vice president, who were specifically named as being among National's nominees on the TSC Board, were the chairman of the TSC Board and chairman of the Board's executive committee, respectively, and (2) that TSC and National in certain other reports previously filed with the SEC had stated the legal conclusion that National "may be a parent of TSC."

Pursuant to Rule 56 of the Federal Rules of Civil Procedure (A51-52) and confronted with conflicting deposition testimony and counteraffidavits, Judge McLaren held against Plaintiff on each ground of the motion either because Plaintiff failed to establish the absence of a genuine issue of material fact (A34, 35, 42, 43) or because Plaintiff was not entitled to judgment in its favor as a matter of law (A38, 40, 44). He identified the "pivotal question" on Plaintiff's motion for summary judgment as being whether these facts "relating to the relationship between TSC and National which were omitted from the joint proxy statement were, as a matter of law, material" (A34). Judge McLaren concluded (A38) that these and other omissions Plaintiff complained of were not material as a matter of law since reasonable men could differ on whether "these facts were so obviously important" as to "have a significant propensity to affect the voting process"—citing this Court's opinion in *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970).

In reaching that conclusion Judge McLaren cited the "similar emphasis" which the Proxy Statement here gives "to the board's recommendation, National's equity interest in TSC, and the number and some of the positions of National's nominees"

(A37). Judge McLaren stressed that, consistent with the applicable regulatory requirements, he "considered the omitted facts in light of the manner in which other facts were disclosed which could have alerted the TSC shareholders to the possible bias of the management and board of TSC" (A38).

On interlocutory appeal pursuant to certification under 28 U. S. C. § 1292(b) (A46), the Seventh Circuit reversed Judge McLaren's denial of summary judgment on the issue of liability, holding that the Proxy Statement violated SEC Rule 14a-9, and remanded the action for further proceedings (A1, 30). The Seventh Circuit expressly rejected this Court's clear expression in *Mills* that omissions in a proxy statement are material only if they have a "significant propensity" to affect the voting process. Instead the panel adopted and applied a much broader test comprehending as material any facts which may be important for "some few stockholders" regardless of their propensity to affect the voting process (A11-12). It made "relevancy alone the critical test of materiality" and stated that even facts which "may be relevant for some but not for others" are material (A9).

The Seventh Circuit recognized that its test will require many facts to be stated which would not come within the scope of what it referred to as the "stricter 'significant propensity' test" relied on by the district court (A9). Applying its test, the Seventh Circuit granted partial summary judgment, holding that certain omissions, all of which were found not to have been material as a matter of law by the district court, were so important that "reasonable minds could not differ on the question of materiality."

The Seventh Circuit adopted its new "might" test on the basis of its singular and narrowly focused reliance on this Court's statement in *Mills* that the determination of a materiality of misstatement or omission "embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of

deciding how to vote." This quoted language immediately precedes this Court's clarifying statement that "[t]his requirement that the defect have a significant *propensity* to affect the voting process is found in the express terms of Rule 14a-9 . . . ." 396 U. S. at 384. The Seventh Circuit, in adopting its "might" test, repeatedly contrasted its approach with the contrary interpretation given to *Mills* by Judge Friendly in the Second Circuit's decision in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281, 1302 (2d Cir. 1973).

REASONS WHY WRIT SHOULD BE GRANTED.

A. The Proper Test of Materiality Is an Important Question of Federal Securities Law on Which a Split of Authority Exists Among the Courts of Appeals and Which Should Be Resolved by This Court.

A uniform and workable definition of "materiality" under the federal securities laws is essential to the fair administration of the shareholder voting process in publicly held companies, as well as SEC Rule 10b-5 and the rules governing registration statements, periodic reports, and tender offers. The materiality test necessarily affects each and every proxy statement pertaining to a corporation whose securities are registered under the 1934 Act. Such corporations represent the greater portion of wealth of United States businesses and the rules applicable to them affect the rights of millions of investors. A judicial determination that a proxy statement omission or misstatement was material often results in serious consequences for the publicly held company and its numerous shareholders. The test of materiality is likewise critically important in registration statements, tender offers and the annual and interim reports of public corporations.

Most of the Courts of Appeals have understood and applied this Court's statement in *Mills* as limiting materiality to matters which have a "significant propensity to affect the voting proc-

ess." Some courts refer to the "significant propensity" test as the "would" test, distinguishing matters that "would" be important to shareholders in deciding how to vote from those that "might" be of importance. The Second Circuit in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281 (2d Cir. 1973) and the Fifth Circuit in *Smallwood* v. *Pearl Brewing Company*, 489 F. 2d 579 (5th Cir. 1974), *cert. denied*, 419 U. S. 873 (1974), both of which involved application of the proxy rules, adopted the "significant propensity" or "would" test and expressly rejected the "might" test adopted by the Seventh Circuit.

In *Smallwood*, the Fifth Circuit said that there was no evidence in *Mills* of any desire by this Court "to relax the standard of materiality to a mere possibility of influence upon a reasonable investor, a standard implied by the word 'might'." On the contrary, the *Smallwood* opinion points out that this Court in *Mills* had emphasized that "the test of materiality required 'a significant *propensity* to affect the voting process'." 489 F. 2d at 604. Similarly, in *Gerstle*, Judge Friendly rejected the word "might" as being "too suggestive of mere possibility, however unlikely" and called for a "realistic standard of materiality." 478 F. 2d at 1302. By contrast, the Seventh Circuit in this action adopted a "might" test and rejected any inquiry as to the propensity of the omitted fact to affect the voting process.

Other Courts of Appeals have adopted the "would" test rather than the Seventh Circuit's "might" test in the related area of liability under Section 10(b) of the 1934 Act and Rule 10b-5. *Titan Group, Inc.* v. *Faggen*, CCH Fed. Sec. L. Rep. ¶ 95,042 (2d Cir. April 1, 1975); *Robinson* v. *Cupples Container Co.*, CCH Fed. Sec. L. Rep. ¶ 95,054 (9th Cir. March 25, 1975); *Marx* v. *Computer Sciences Corp.*, 507 F. 2d 485 (9th Cir. 1974); *Gordon* v. *Burr*, 506 F. 2d 1080 (2d Cir. 1974); *Harnett* v. *Ryan Homes, Inc.*, 496 F. 2d 832 (3d Cir. 1974); *Vohs* v. *Dickson*, 495 F. 2d 607 (5th Cir. 1974); *Rochez Bros., Inc.* v. *Rhoades*, 491 F. 2d 402 (3d Cir. 1974); *Arber* v. *Essex Wire Corp.*, 490 F. 2d

414 (6th Cir. 1974), *cert. denied*, 419 U. S. 830 (1974); *John R. Lewis Inc.* v. *Newman*, 446 F. 2d 800 (5th Cir. 1971); *Herpich* v. *Wallace*, 430 F. 2d 792 (5th Cir. 1970).

The "would" test has also been adopted in determining liability for defective tender offers under Section 14(e) of the 1934 Act. *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F. 2d 341 (2d Cir. 1973), *cert. denied*, 414 U. S. 910 (1973); *Gulf & Western Industries, Inc. v. Great A. & P. Tea Company, Inc.*, 476 F. 2d 687 (2d Cir. 1973); *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F. 2d 937 (2d Cir. 1969). It has also been adopted under Section 12(2) of the Securities Act of 1933. *Johns Hopkins University* v. *Hutton*, 422 F. 2d 1124 (4th Cir. 1970).

The test of materiality used by the Courts of Appeals which follow *Mills* is consistent with SEC's definition of the term "material" in Rule 1-02 in Regulation S-X, namely:

> "*Material.* The term 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters about which an average prudent investor ought reasonably to be informed." 17 C.F.R. § 210.1-02(m)*

The Seventh Circuit, in rejecting significant propensity and "would" and in adopting "might", realized that different conclusions on materiality would be reached depending upon which test is used (A9).

The distinction between the "significant propensity" test laid down in *Mills* and followed by most circuits and the Seventh Circuit's "might" test is fundamental. The "significant propensity" test is designed to limit the concept of materiality to information which objectively relates in some significant manner or basic respect to the issue presented to the shareholder. The

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* In an amicus brief which the SEC filed in the Seventh Circuit, it did not urge that the "significant propensity" test applied by the district court should be modified but focused its arguments only on the materiality of the claimed omissions under that test.

SEC's rule expressly limits materiality on the basis of a similar objective standard of significance. In contrast, the Seventh Circuit's test, by its emphasis on relevance and on subjective importance to "some few shareholders", effectively removes the intended limiting effect of materiality and makes most relevant facts material and subject to the SEC's disclosure requirements.

The lack of a uniformly recognized test of materiality conflicts with the federally mandated duty of public corporations to prepare and issue proxy statements to shareholders on a nationwide basis. This Court's enunciation of a uniform standard would eliminate the current problem where the choice of forum can determine whether the proxy material of a national corporation is actionable because of material omissions.

This case clearly presents an appropriate vehicle for the Court to enunciate such a uniform standard of materiality. In many cases misstatements or omissions may be so clearly material that there is no need nor occasion to focus on the standard of materiality. In this case, however, the outcome turns on the test applied. This is evidenced by Judge McLaren's denial of summary judgment under the "significant propensity" test and his reversal by the Seventh Circuit under its new test which, as it recognized, encompassed many facts not covered by the "significant propensity" test.

An authoritative ruling by this Court on this important issue of "materiality" is needed not only because the Seventh Circuit misread *Mills*, but also because even those circuits which have followed *Mills* have indicated that they do not regard *Mills* as constituting a "determination of the proper test of materiality." See *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d at 1301. In *Mills* the Court specifically dealt only with the issue of causation and did not review the holding of the lower court that the proxy statement there was misleading in material respects. 396 U. S. at 381, n. 4.

B. The Seventh Circuit's Novel Test of Materiality Imposes an Unworkable Burden and Is Unnecessary to Assure Adequate and Fair Disclosure to Investors.

The Seventh Circuit now requires proxy statement authors to include everything relevant which *might* be important to a reasonable shareholder in the process of deciding how to vote, rejecting *any* inquiry into whether or not the omission would have any effect on the shareholder vote.

The appropriateness of any standard of materiality under SEC Rule 14a-9 must be placed in its proper context. Over a forty-year period the SEC has issued and revised its rules and regulations embodied in Schedule 14A, 17 C. F. R. § 240.14a-101, requiring many specific items of disclosure in proxy statements. The omissions complained of in the instant case are not in violation of *any* item of disclosure specified in Schedule 14A. They are violations, if at all, of Rule 14a-9(a)*, a general catch-all provision which requires disclosure of certain additional material matters.

The Seventh Circuit would require submission to shareholders of voluminous relevant information which "might" be of importance to some few shareholders in the process of deciding how to vote. This would impose an unfair burden and could not serve as a workable guide for measuring what is required to be included in a proxy statement. Required matters should be confined to what is needed reasonably to inform investors. The Seventh Circuit's novel test plainly conflicts with SEC's definition of "material" in Rule 1-02 which applies to the four basic securities laws the Commission administers. The SEC's defini-

* In pertinent part, Rule 14a-9(a) provides: "No solicitation subject to this regulation shall be made by means of any proxy statement . . . containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading. . . ." (A49)

tion expressly "limits the information required to those matters about which an average prudent investor ought reasonably to be informed."

The novel test of materiality adopted by the Seventh Circuit, emphasizing as it does "relevance for some investors" rather than a "significant propensity to affect the voting process" (A9), is clearly impractical and imposes an intolerable burden upon all public companies. Proxy statements often deal with complex transactions such as mergers and acquisitions which may involve literally thousands of relevant facts which might arguably be of interest to some shareholders. It is impossible to include in proxy statements, other SEC filings and published data such as annual and interim reports to shareholders, all of the information which *some* few shareholders might regard as relevant.

For example, in describing the business of a company to be acquired, an attempt to include all facts someone might regard as relevant would require scores of pages and yet would almost certainly fail to satisfy the Seventh Circuit's test. Those who prepare proxy statements must make many judgments distinguishing between those facts which should be disclosed to shareholders to highlight the basic considerations touching a transaction submitted to them for their approval and those less important items of relevant data which can and should be left out as being redundant, cumulative or mere details. Indeed, it is this differentiation which underlies the requirement of adequate and fair disclosure and is at the very heart of the "significant propensity" test.

The Seventh Circuit's test would compel the accumulation and recitation in a proxy statement of all facts, regardless of objective significance, which might be important to some shareholders. This is plainly at odds with the disclosure duties spelled out in the federal securities laws.

Moreover, since it is impossible to include in a proxy statement a complete statement of all facts which might be relevant to

some shareholder, such approach would—in effect—give shareholders an option to force a rescission of any transaction if, upon hindsight, the transaction appears unfavorable. This would open the federal courthouse to a flood of additional lawsuits by disgruntled stockholders latching on to the omission of what is relevant instead of what had a significant propensity to affect the voting process.

The Congress intended to assure adequate and fair disclosure, not to impose an unrealistic burden of accumulating all that is relevant, failing which stockholders would have the option to rescind a transaction or obtain damages. Judge Friendly described the problem and its solution in a case involving the disclosure requirements relating to tender offers in *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F. 2d 937, 948 (2d Cir. 1969):

> "Probably there will no more be a perfect tender offer than a perfect trial. Congress intended to assure basic honesty and fair dealing, not to impose an unrealistic requirement of laboratory conditions. . . ."

Judge McLaren appreciated this distinction, observing that

> "It has been recognized that '[i]t is easy to find small errors or trivial omission in any proxy statement'. . . ." (A38).

A workable standard should include an inquiry into whether the omission is likely to affect the voting process. This inquiry need not involve the kind of factual demonstration of causation this Court sought to avoid in *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970) and *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128 (1972), but should be based on the objective reasonable man standard. Propensity to affect the voting process gives a practical dimension to materiality—that the omission or misstatement is likely to alter the outcome of shareholder voting.

C. The Seventh Circuit Misused Summary Judgment, and Hence Improperly Foreclosed TSC and National from a Trial as to the Issue of the Materiality of the Complained of Omissions, by Finding Such Omissions to Be Material as a Matter of Law.

Plaintiff's motion before Judge McLaren was for partial summary judgment against TSC and National on the issue of liability alone. Necessarily, the motion was based on the premise that certain omissions from the Proxy Statement were "material" as a matter of law and that consequently the Proxy Statement was fatally defective under the disclosure requirements of the 1934 Act and the proxy rules issued thereunder. Under Rule 56(c) of the Federal Rules of Civil Procedure, Plaintiff had the burden of showing that there was no genuine issue as to any material fact and that Plaintiff was entitled to judgment on the issue of liability as a matter of law.

Ordinarily materiality of an omission is a question of fact, to be determined by the trier of fact. Only when reasonable men may not differ on the issue of materiality can it be determined as a matter of law. *Johns Hopkins University* v. *Hutton*, 422 F. 2d 1124, 1129 (4th Cir. 1970); *Rogen* v. *Ilikon Corp.*, 361 F. 2d 260, 266 (1st Cir. 1966). If different permissible inferences may be drawn from the underlying facts in the summary judgment record, no summary judgment may be granted. *United States* v. *Diebold, Inc.*, 369 U. S. 654, 655 (1962).

After considering the entire summary judgment record, including uncontroverted opposing affidavits filed by TSC and National as evidence that National lacked the power to direct or cause the direction of TSC's management, Judge McLaren concluded that Plaintiff had failed to establish the absence of a genuine question of fact as to the material issue of whether National was in control of TSC (A34).

The Seventh Circuit agreed that there was a bona fide dispute on the issue of National's alleged control of TSC (A6) and

also agreed with Judge McLaren's holding that Plaintiff must establish undisputed facts sufficient to show that one or more of the items omitted from the Proxy Statement was material as a matter of law in order to render the Proxy Statement fatally defective under Rule 14a-9. The panel also concurred with the district judge that to establish materiality as a matter of law, it must be shown that reasonable minds could not differ on the question of materiality (A7).

However, the Seventh Circuit then proceeded to announce its own lesser test of materiality, saying that relevancy is the only real criterion and it would be sufficient for the omitted facts to be of importance to some few stockholders (A8-9). Thus, the panel set itself apart from this Court's opinion in *Mills*, as well as from Judge McLaren who concluded that the omissions Plaintiff complained of were not material as a matter of law since reasonable men could differ on whether "these facts were so obviously important" as to "have a significant propensity to affect the voting process" (A38).

In applying its new test the Seventh Circuit granted summary judgment, treating as material omissions from the Proxy Statement references to prior SEC filings in which TSC and National had stated the legal conclusion that National "may be a parent of TSC," and the fact that National's president and executive vice president, who had been specifically named at page 6 of the Proxy Statement as being among National's nominees on the TSC Board, were respectively the chairman of the TSC Board and the chairman of the Board's executive committee. In the light of the prominent and accurate disclosures actually made in Proxy Statement those complained of omissions could not have had any effect on the voting process. At most such omissions posed issues for the trier of fact.

The other omissions which the Court of Appeals found material as a matter of law were a letter opinion of TSC's investment banker, Hornblower & Weeks-Hemphill, Noyes, regarding

the value of National's warrants (A43-44) and the open market purchases of National's common stock by Madison Fund, a diversified investment company which had purchased both National debentures and National common stock at various times during 1968 and 1969 (A40-42). Due to the disputed issues of fact and the incomplete record, the significance of these omissions was not ripe for determination on summary judgment and no proper finding as to their propensity to affect the voting process could have been made (A38, 43-44). Accordingly, on this record proper application of the *Mills* test would not result in a finding that these omissions were material as a matter of law.

The Seventh Circuit plainly misused summary judgment procedure in holding that all these omissions were material as a matter of law. This was contrary to Judge McLaren's decision that a trial was necessary after making his detailed fact and law analysis. To reach such conclusions the court below had to espouse its own novel test of materiality under the securities laws in which it employs a "might have" test and treats relevancy of the omitted factual material as the only criterion of materiality.

Obviously, by placing the threshold of materiality so low as to require only that the omitted fact be relevant and deemed important by some few shareholders (A9), many truly redundant, cumulative and *de minimis* factual matters can be transformed into "material" facts. This novel test was the vehicle the Seventh Circuit used in abusing summary judgment and thereby unfairly foreclosing TSC and National from a trial on the issue of materiality of the complained of omissions.

CONCLUSION.

For the foregoing reasons the Court should grant this petition for a writ of certiorari.

Respectfully Submitted,

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May 23, 1975.

EXHIBIT TO PETITION

Pages 6-7 of Proxy Statement
(Vol. III, Part 1, Ex. A to Complaint)

PROPOSED AGREEMENT TO SELL TSC'S ASSETS TO NATIONAL AND LIQUIDATION AND DISSOLUTION OF TSC

Boards of Directors Approval

The Boards of Directors of National and TSC have approved the Agreement and believe that the transactions contemplated thereby are in the best interests of the shareholders of both corporations, who will benefit through the diversified activities of the surviving corporation. In reaching their decision the Boards of Directors of each corporation considered not only recent market prices of the securities of the two corporations, but also the preferred dividend to be paid to the TSC stockholders, the businesses and financial conditions of both corporations and various other factors.

At the request of TSC, the investment banking firm of Hornblower & Weeks-Hemphill, Noyes rendered a favorable opinion as to the fairness to the stockholders of TSC of the terms, set forth below, for the exchange of the shares of TSC for securities of National. The TSC Board considered this opinion in approving the sale. In such opinion, said firm considered, among other things, the current market prices of the securities of both corporations, the high redemption price of the National Series B Preferred Stock, the dividend and debt service requirements of both corporations, the substantial premium over current market values represented by the securities being offered to TSC stockholders, and the increased dividend income.

Hornblower & Weeks-Hemphill, Noyes did not receive a fee for its services. Mr. Blancke Noyes, a partner in said firm is, and has been since 1968, a Director of TSC. Mr. Noyes is the owner of 500 shares of TSC Series 1 Preferred Stock, 1,000 shares of TSC Common Stock and 100 shares of National Common Stock. Mr. Noyes' wife also beneficially owns 1,000 shares of TSC Common Stock. In March 1969, Hornblower & Weeks-Hemphill, Noyes acted as the principal underwriter in the public offering of 195,000 shares of TSC Common Stock.

National's Equity Interest in TSC

As noted above, National owns 519,733 shares (approximately 28%) of the presently outstanding shares of TSC Common Stock and 439,675 shares (approximately 46%) of the presently outstanding shares of TSC Series 1 Preferred Stock.

On February 7, 1969, National purchased from Mr. Charles E. Schmidt (then a director of TSC), his wife, his two sons, and a charitable foundation of which Mr. Schmidt was a trustee, 434,682 shares of Common Stock of TSC for cash and notes of National, totalling $13,040,460 ($30.00 per share) and 439,675 shares of TSC Series 1 Preferred Stock for cash and notes of National totalling $9,892,687.50 ($22.50 per share), the total of $22,933,147.50 being payable one-fourth in cash and three-fourths in 5% Notes of National payable in six annual installments. In addition, National transferred Warrants to said sellers granting them the right to purchase a total of 125,000 shares of Common Stock of National during the year commencing February 7, 1974 at $24 a share, subject to certain anti-dilution provisions.

Pursuant to an Agreement dated October 14, 1969, National purchased from Mr. Orville E. Peterson, a director of TSC and President of Big Bear, Inc., a subsidiary of TSC, his wife, brother and their immediate families 85,051 shares of Common Stock of TSC for cash and notes of National totalling $1,190,714 ($14.00 per share), being payable one-tenth in cash and the balance in 5% notes of National payable in six annual installments beginning on January 2, 1970.

National's Nominees on TSC's Board

At the request of National, Mr. Stanley R. Yarmuth, President and a Director of National, Mr. Charles F. Simonelli, Executive Vice President and a Director of National, Mr. Allan B. Solomon, Vice President of National, and Mr. Hyman Ullner, Cincinnati, Ohio, were elected Directors of TSC at the Annual Meeting of Stockholders of TSC held on March 31, 1969. At a subsequent Directors' Meeting, Mr. Jack Segell, President of G*E*S Stores, Incorporated, a subsidiary of National, was

elected a Director of TSC. The remaining directors of TSC, namely Mr. Blancke Noyes, Mr. Orville E. Peterson, Mr. Richard H. Schaefer, President of TSC, Mr. Max J. DeForest, Vice President of TSC's Tractor Division, and Mr. Carl W. Sharfman, Vice President of TSC, are not affiliated with National.

Proposed Transaction

Under the applicable provisions of the Agreement, on the Closing Date (therein defined) TSC will sell to Transferee substantially all its assets, properties and business. In consideration therefor, Transferee will assume substantially all of the liabilities of TSC, and National will issue to TSC sufficient National securities so that each outstanding share of TSC Series 1 Preferred Stock will be exchanged upon liquidation of TSC for .6 share of National Series B Preferred Stock and one National Warrant, and each share of TSC Common Stock will be exchanged for .5 share of National Series B Preferred Stock and one and one-half National Warrants.

Each full share of National Series B Preferred Stock will be entitled to a cumulative quarterly dividend at the annual rate of $1.25 a share, accruing from the last dividend payment date, will be convertible, on and after the date of issuance, into .75 share of National Common Stock (subject to adjustment), will be entitled to one vote, may be redeemed by National at any time after the Closing Date at $26 per share, and will be entitled to a preference on liquidation of National.

Each National Warrant will entitle the holder to purchase one share of National Common Stock at a price of $21.40 per share (subject to adjustment) until October 31, 1978. For a further description of the terms and provisions of the National Capital Stock, the National Series B Preferred Stock and the National Warrant, see "Description of Capital Stock" and "Description of Warrants of National" herein and Appendices 1, 2 and 3 to the Agreement enclosed herewith as Exhibit B.

The National Series B Preferred Stock and National Warrants received by National as a stockholder of TSC will, when received by National in the liquidation and dissolution of TSC, be held in National's treasury until cancelled and retired or reissued.

The Agreement also provides, among other things, that:

(a) After the Closing TSC will, in accordance with the Plan of Complete Liquidation, promptly distribute to its stockholders in liquidation, the shares of National Series B Preferred Stock and National Warrants issued by National to TSC and will thereafter dissolve.

(b) TSC's name shall be changed to "TS Liquidating Company".

(c) National will assume the obligations of TSC under its employee stock options outstanding on the Closing Date. Each option to purchase shares of TSC will become options to purchase the maximum number of shares of Common Stock of National at the lowest price per share as is permitted by the Internal Revenue Code without such assumption being considered a modification thereunder.

(d) From the date of the Agreement to the Closing Date, TSC will not, without the prior written consent of National, declare or pay any dividend in excess of the regular quarterly dividend of $.175 per share on its Series 1 Preferred Stock or declare or pay any dividend on its common stock.

If approved at the shareholders' meetings, and unless abandoned or terminated as provided in the Agreement (see "Rights of Termination" below), the sale of assets will be consummated as soon as practicable after the shareholders' meetings.

Other Provisions of Acquisition Agreement

There is set forth below a summary of certain other provisions of the Agreement. The preceding discussion of the Agreement and the following summary does not purport to be complete, and are subject in all respects to the provisions of the Agreement, a copy of which is enclosed herewith as Exhibit B.

Fractional Interests. No fractional shares of National Series B Preferred Stock or fractional interests in National Warrants (and no scrip certificates for any of the foregoing) will be issued.

APPENDIX A.

IN THE UNITED STATES COURT OF APPEALS,
For the Seventh Circuit.

No. 73-1922

NORTHWAY, INC., a Delaware corporation,

Plaintiff-Appellant,

vs.

TSC INDUSTRIES, INC., a Delaware corporation, NATIONAL INDUSTRIES, INC., a Kentucky corporation, and TSC INDUSTRIES, INC. (formerly named NII, INC., and being the successor to the business, assets and corporate name of the said TSC INDUSTRIES, INC.) a Delaware corporation, CHARLES E. SCHMIDT, DOROTHY F. SCHMIDT, RICHARD L. SCHMIDT, CHARLES E. SCHMIDT, JR., CHARLES E. SCHMIDT and DOROTHY F. SCHMIDT FAMILY FOUNDATION,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division—No. 69 C 2513.

RICHARD W. MCLAREN, *Judge.*

Argued September 12, 1974—Decided March 5, 1975

Before SWYGERT, CUMMINGS and PELL, *Circuit Judges.*

SWYGERT, *Circuit Judge.* This appeal concerns violations of Rules 14a-3 and 14a-9 issued by the Securities Exchange Commission pursuant to section 14(a) of the Securities Exchange Act of 1934, 15 U. S. C. § 78n(a). This section makes it

unlawful for any person to solicit by mail or other means of interstate commerce proxies of a registered security in violation of rules promulgated by the Commission pursuant to the statute. The appeal also concerns alleged violations of section 78j(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

Plaintiff Northway, Inc. brought this action against defendants National Industries, Inc. and TSC Industries, Inc. for alleged violations of section 14a in connection with the acquisition of TSC by National in a stock-for-stock purchase. Northway alleges that these corporate defendants issued a joint proxy statement in connection with a take-over, which statement was incomplete and materially misleading. In addition, Northway brought suit against Charles E. Schmidt and various members of his family alleging that these defendants also violated the Securities and Exchange Act by selling their controlling interest in TSC without adequately protecting the interests of its other shareholders. The Schmidt defendants were also charged with aiding and abetting the corporate defendants. Northway appeals from orders of the district court denying its motion for summary judgment on the issue of liability of the corporate defendants, denying its similar motion as to the Schmidt defendants, and granting a cross-motion for summary judgment filed by the Schmidt defendants. Appeal is taken by leave pursuant to 28 U. S. C. § 1292(b), the district court and this Court having found that the disposition of these motions involves controlling and important questions of law as to which there is substantial ground for difference of opinion, and that immediate appeal may materially advance the ultimate termination of this litigation. We affirm the granting of summary judgment for the Schmidt defendants, but reverse the denial of summary judgment as to the liability of the corporate defendants.

I

Plaintiff Northway is a Delaware corporation doing business in Illinois, where it maintains its principal place of business. In January and February of 1969 Northway owned 200 shares of common stock in TSC Industries, also a Delaware corporation. Northway continued to own the TSC stock throughout the period of the transactions challenged in this lawsuit.

As of January 16, 1969 Charles E. Schmidt, Sr. and various members of his family owned approximately one third of the outstanding voting shares in TSC.[1] In addition, Mr. Schmidt and his son, Charles E. Schmidt, Jr., were members of the TSC board of directors. On that day, Mr. Schmidt was approached by representatives of National Industries, Inc., a Kentucky corporation, who inquired into the possibility of acquiring all of the Schmidt family interest in TSC.[2] After reviewing his own financial position and after an evaluation of National Industries and its key personnel, Mr. Schmidt determined that he would move ahead with the sale. On January 30, 1969 a stock purchase agreement was signed. Under the agreement, the Schmidt defendants were to receive substantially the then market value for their TSC securities. Payment was to be in cash and National's 5% notes payable in six annual installments.[3] Immediately after signing the agreement Mr. Schmidt

1. Mr. Charles E. Schmidt, Sr. owned 411,703 shares of TSC common stock and 338,974 shares of its preferred stock. A residue of 16,137 common shares and 100,601 preferred shares was owned in various proportions by Dorothy F. Schmidt, Richard L. Schmidt, Charles E. Schmidt, Jr. and the Charles E. Schmidt and Dorothy F. Schmidt Family Foundation.

2. The meeting with the National representatives had been arranged by Mr. Schmidt's neighbor, Mr. Frank Cryan, without Mr. Schmidt's knowledge or prior consent. Mr. Schmidt was informed that the meeting had been arranged on the morning of the 16th.

3. National agreed to pay $30 per share for the common stock and $22.50 per share for the preferred. A cash payment of 25% was agreed to, with the balance payable in five annual installments

(Footnote continued on next page)

tendered his resignation from the board of directors of TSC. Mr. Schmidt's son, Charles E. Schmidt, Jr., tendered his resignation from the TSC board of directors on February 7, 1969, the date of closing of the stock transfer. The Schmidt defendants had no further contact with TSC or National after February 7, 1969.

Shortly after the acquisition of the Schmidt interests, on March 31, 1969, four National nominees were elected to the ten-man board of directors of TSC.[4] On that same day, Stanley R. Yarmuth, president and chief executive officer of National, became the chairman of the TSC board of directors and Charles F. Simonelli, executive vice president of National, became chairman of the TSC executive committee.

On October 16, 1969, a proposal to liquidate and dissolve TSC and to sell all its assets to National was considered at a meeting of the TSC board of directors. Under the proposal National was to acquire all TSC assets in return for National securities. Eight members of the TSC board of directors attended this meeting.[5] The proposition received the affirmative votes of four non-National directors. The three National nominees on the TSC board attending the meeting abstained from

of 10% of the *total* price and a sixth installment of the remaining 25% in the sixth year. In consideration of the low interest rate of 5% on the deferred notes, National gave the Schmidts 125,000 warrants for the purchase of National common stock at $24 per share exercisable during the one year period between February 7, 1974 and February 7, 1975.

4. The four National nominees were Mr. Stanley R. Yarmuth, president and a director of National, Mr. Charles F. Simonelli, executive vice-president and a director of National, Mr. Allan B. Solomon, vice-president of National, and Mr. Hyman Ullner, of Cincinnati, Ohio. Subsequently, Mr. Jack Segell, President of G*E*S Stores, Inc., a subsidiary of National, was elected to the TSC board.

5. Attending were National nominees Messrs. Yarmuth, Solomon and Segell, and non-National board members Max J. DeForest, Blanke Noyes, Orville E. Peterson, Richard H. Schaefer and Carl W. Scharfman.

voting on the advice of their attorneys. One non-National director also abstained.

On November 12, 1969, TSC and National issued a joint proxy statement to the shareholders of TSC concerning the proposed liquidation and sale. The statement urged TSC shareholders to approve the transaction. Sufficient proxies were received and voted in favor of the proposal to cause it to be approved. TSC was placed in liquidation and dissolution and notices were sent to all TSC stockholders advising them that they were required to exchange their TSC shares for National securities. Shares were exchanged and the transaction completed.

II

Corporate defendants National Industries, Inc., and TSC, Inc. are charged with violations of § 14(a) of the Securities Exchange Act of 1934, 15 U. S. C. § 78n(a),[6] and Rules 14a-3 and 14a-9 thereunder.[7] The 14a-3 claim is based on the failure of the corporate defendants to include in the joint proxy statement the conclusion that a change in control of TSC had taken place as a result of the transfer of the Schmidt interests in TSC to National.[8] The 14a-9 claim is based on the

6. § 14(a) provides:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 781 of this title.

7. 17 C. F. R. § 240.14a-3; 17 C. F. R. § 240.14a-9.

8. Rule 14a-3(a) provides that:

> No solicitation subject to this regulation shall be made unless each person solicited is concurrently furnished or has previously been furnished with a written proxy statement containing the information specified in Schedule 14A.

(Footnote continued on next page)

failure of the corporate defendants to include certain material information in the joint proxy statement concerning the degree of potential influence of defendant National in the management of TSC, the favorability of the terms of the National acquisition proposal to the TSC shareholders, and the formal approval by the TSC board of directors of the resolution of liquidation and dissolution.[9]

We agree with the district court that the issue of control is a factual issue presently in dispute and that summary judgment as to the Rule 14a-3 claim would have been inappropriate. The essence of the 14a-3 claim is that the proxy statement failed to disclose, in accordance with Schedule 14A, that a change of control of TSC had taken place during the preceding fiscal year. Each side has presented exhibits and affidavits tending to support their conflicting views on the control issue. The trial court properly denied Northway's motion in the face of this bona fide dispute.

Plaintiff's Rule 14a-9 motion for summary judgment is quite different from the 14a-3 motion. The central question under Rule 14a-9 is whether, considering all of the circum-

Schedule 14A, Item 5, requires:

(e) If to the knowledge of the persons on whose behalf the solicitation is made a change in control of the issuer has occurred since the beginning of the last fiscal year, state the name of the person or persons who acquired such control, the basis of such control, the date and a description of the transaction or transactions in which control was acquired and the percentage of voting securities of the issuer now owned by such person or persons.

9. Rule 14a-9 provides:

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, notice of meetings or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

stances which existed at the time the joint proxy statement was issued, the proxy statement was false or misleading in its presentation of a material fact or in its failure to include such a fact. Northway contends that the statement was misleading because of five omissions of fact, all of which it says were material. To prevail on the 14a-9 issue Northway must establish undisputed facts sufficient to show that one or more of the omitted items is material as a matter of law. To do this, it must demonstrate that reasonable minds could not differ on the question of materiality. *Johns Hopkins University* v. *Hutton*, 422 F. 2d 1124, 1129 (4th Cir. 1970); *Beatty* v. *Bright*, 318 F. Supp. 169, 173 (S. D. Iowa 1970); *Berman* v. *Thompson*, 312 F. Supp. 1031, 1034 (N. D. Ill. 1970).

In *Mills* v. *Electric Autolite Co.*, 396 U. S. 375, 90 S. Ct. 616, 24 L. Ed. 2d 593 (1960), the Supreme Court addressed itself to the elements of a cause of action brought under Rule 14a-9. The Court held that once materiality is established, specific proof of causation is unnecessary providing it is shown that the proxy statement itself was an essential link in the transaction. The Court thus recognized that the concept of materiality is itself defined in terms of potential causative effects.[10]

10. The pertinent language is:

Where the misstatement or omission in a proxy statement has been shown to be "material," as it was found to be here, that determination itself indubitably embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote. This requirement that the defect have a significant *propensity* to affect the voting process is found in the express terms of Rule 14a-9, and it adequately serves the purpose of ensuring that a cause of action cannot be established by proof of a defect so trivial, or so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by § 14(a).

There is no need to supplement this requirement, as did the Court of Appeals, with a requirement of proof of whether the defect actually had a decisive effect on the voting. Where there

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Since *Mills*, some uncertainty has developed as to which language in that opinion represents the proper test to apply in determining the materiality of an omitted fact. Different results could flow from a test requiring only that the omitted fact "might have been considered important by a reasonable shareholder who was in the process of deciding how to vote" than would flow from a test requiring that the fact have "a significant *propensity* to effect the voting process."[11] On a motion for summary judgment, the "might have" test would ask whether a reasonable mind could conclude that the omitted fact is so irrelevant that it would never reasonably be considered important. The "significant propensity" test would ask whether a reasonable mind could conclude that the fact is less than significant in its potential to affect the voting process. Many facts which are revelant within the first test could reasonably be said to have less than a significant propensity to affect the voting process taken as a whole, even though for some few stockholders these same facts could be determinative.

has been a finding of materiality, a shareholder has made a sufficient showing of casual [sic.] relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction. This objective test will avoid the impracticalities of determining how many votes were affected, and, by resolving doubts in favor of those the statute is designed to protect, will effectuate the congressional policy of ensuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions. 396 U. S. at 384-85.

11. The district judge twice stated the burden of plaintiffs in this case in terms of the "might have been considered important" test:

> To establish a violation [of Rule 14a-9], plaintiff must prove . . . (b) that the misstatement or omissions were material in the sense that they "might have been considered important by a reasonable shareholder who was in the process of deciding how to vote." . . .
>
> The pivotal question as to plaintiff's motion for summary judgment on this ground is thus whether certain facts relating to the relationship between TSC and National which were omitted from the joint proxy statement were, as a matter of law, material. To meet its burden, plaintiff must show that the facts withheld were so obviously important to TSC shareholders that reasonable minds could not differ on the question of whether the shareholders might have considered them important. 361 F. Supp. at 111-12.

But in denying plaintiff's motion for summary judgment, he specifically relied on the stricter, "significant propensity" test:

> While the Court believes that the prior claims of control made to the SEC and Yarmuth's and Simonelli's other positions might have been considered important by TSC shareholders, it cannot conclude that these facts were so obviously important that reasonable minds could not differ on the issue; that is, as to whether they would have a significant propensity to affect the voting process. 361 F. Supp. at 114.

We believe the policies which underlie § 14(a) and Rule 14a-9 are best served by a test that includes all facts which a reasonable stockholder might consider important. We are mindful of Judge Friendly's thorough consideration of this question and of the criticism that such a test is "too suggestive of a mere possibility, however unlikely." *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281, 1302 (2d Cir. 1973). Yet we think any test which does not require the inclusion of facts which *could* influence a reasonable stockholder would seriously undercut the intended prophylatic effect of these disclosure provisions. Any speculation under such a test is limited by the "reasonable stockholder" language therein and by the overriding purposes of § 14(a),[12] from which any test must take its meaning and to which Justice Harlan specifically referred in *Mills*. This test will not reach "trivial" and "unrelated" facts; neither will it fail to reach facts which may be relevant for some, but not for others.

We are convinced that the test we adopt is supported by the reasoning of the Supreme Court in *Mills* and in *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 92 S. Ct. 1456,

12. The Court has said that the 1934 Act and its companion legislative enactments embrace a "fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry. *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 151, 92 S. Ct. 1456, 31 L. Ed. 2d 741 (1972).

31 L. Ed. 2d 741 (1972). These cases held that proof of causation or actual reliance is unnecessary to establish liability under Rules 14a-9 and 10b-5 in connection with a failure to disclose, and that causation is established once it is shown that the facts in question might have been considered important by a reasonable stockholder. It would make little sense to hold that causation is established by a more lenient standard than materiality. In fact any test of materiality which requires a finding of some probability that the omitted fact would affect the voting process necessitates the same difficult proofs the Supreme Court sought to avoid by eliminating the need for independent proof of causation or reliance.[13]

13. While Judge Friendly saw the distinction between "would" and "might" as small, perhaps even "gossamer," *Gerstle, supra,* at 1302, we believe that *Mills* and *Ute* preclude such an analysis. Once the element of probability becomes a part of the materiality test, a mere showing of relevancy of omitted facts is inadequate to establish a violation of 14a-9 or 10b-5. Under a probability test, we cannot see how the plaintiff would prevail without introducing some evidence, direct or indirect, tending to show that the challenged omission had an actual impact in his case. If there is a distinction, in the trial context, between proofs which show that a particular omission would have been relied upon, and those which show that the omission was in fact relied upon, it is so subtle as to have no practical significance. We believe that relevancy alone is the critical test of materiality and that when relevant facts are withheld from a proxy solicitation, materiality is established independent of any proofs of probable reliance or causation.

It is interesting to note that Judge Friendly cites *List* v. *Fashion Park, Inc.*, 340 F. 2d 457, 462 (2d Cir., 1965), *cert. denied,* 382 U. S. 811, 86 S. Ct. 23, 15 L. Ed. 2d 60 (1965) and *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968), *cert. denied,* sub nom. *Coates* v. *Securities and Exchange Commission,* 394 U. S. 976, 89 S. Ct. 1454, 22 L. Ed. 2d 756 (1969) in support of the probability test. Neither case is absolutely clear on the precise test of materiality. In *List,* although the court quotes the Restatement of Torts § 538(2)(a) to the effect that material facts are those to which "a reasonable man *would* attach importance" (emphasis added), it also quotes with approval this court's holding in *Kohler* v. *Kohler Co.*, 319 F. 2d 634 (7th Cir. 1963) that material facts include those facts "which in reasonable and objective contemplation *might* affect the value of the corporation's stock or securities." *Id.* at 642. In *Texas Gulf Sulphur, both* tests approved in *List* are quoted, and the court further holds that

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Finally, we cannot agree with the argument that the Supreme Court has twice included the "might have" test without specific consideration of the materiality issue itself. See *Gerstle* v. *Gamble-Skogmo, Inc., supra* at 1301-02 and n. 21; *Smallwood* v. *Pearl Brewing Company,* 489 F. 2d 579, 604 (5th Cir. 1974). Had Justice Blackmun intended to leave the definition of materiality open in *Ute,* he could have done so. He chose not to, but instead adopted the essence of the *Mills* test:

> [D]efendants devised a plan and induced the mixed blood holders of UDC stock to dispose of their shares without disclosing to them material facts which could have been expected to influence their decisions to sell. . . .
>
> Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. 406 U. S. at 153-54.

This is entirely consistent with the purposes of disclosure requirements and with the policy of "resolving doubts in favor of those the statute is designed to protect." *Mills* v. *Electric Autolite Co.*, 396 U. S. at 385.

Having concluded that the proper test of materiality is whether the omitted fact is "of such a character that it might have been considered important by a reasonable shareholder

> material facts include not only information disclosing the earnings and distributions of a company but also those facts which affect the probable future of the company and those which *may* affect the desire of investors to buy, sell or hold the company's securities. 401 F. 2d at 849. (emphasis added)

Indeed, Judge Friendly himself used a "mixed" test in *General Time Corp.* v. *Talley Industries, Inc.*, 403 F. 2d 159 (2d Cir. 1968), *cert. denied,* 393 U. S. 1026, 89 S. Ct. 631, 21 L. Ed. 2d 570 (1969):

> The test, we suppose, is whether, taking a properly realistic view, there is a substantial likelihood that the misstatement or omission *may* have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course. *Id.* at 162. (emphasis added)

who was in the process of determining how to vote," *Id.* at 384, we consider the five separate facts omitted from the joint proxy statement in this case.

A

Northway's initial charge is that the joint proxy statement failed to disclose two material facts related to the question of National's potential influence over the management of TSC. Specifically, the proxy failed to show that both TSC and National had filed special reports with the Securities Exchange Commission indicating that the transfer of the Schmidt interests had resulted in a change in control of TSC and that National could be deemed the "parent" of TSC as a result of that transfer.[14] The statement also failed to show that at the time

14. In connection with the acquisition of the Schmidt interests by National, both National and TSC filed special reports with the SEC in compliance with the Securities Exchange Act of 1934. National filed a Schedule 13D in compliance with § 13(d) of the Act, 15 U. S. C. § 78m(d). Item four in that schedule requires that if the *purpose of the acquisition is to acquire control* of the business of the issuer, any plans or proposals of the acquiring party to make major changes in that business must be disclosed. In response to that item, National stated in part:

> National has acquired approximately 33% of the outstanding voting shares of TSC, Inc. Accordingly, National may be deemed to be a "parent" of TSC as that item is defined in the Rules and Regulations under the Securities Act of 1933.

TSC filed Forms 10-K and 8-K in compliance with section 15(d) of the Act, 15 U. S. C. § 78o. The Form 10-K, at Item 3(a), contained language identical to that found in National's 13D filing indicating that National could be deemed to be the "parent" of TSC. The Form 8-K, at Item 1, entitled "Changes in Control of Registrant," contained a reference back to the "parent" language in Form 10-K.

The definition of the term "parent" is found at S.E.C. Rule 12b-2(a), (f), (k), 17 C. F. R. § 240.12b-2(a), (f), (k):

> Unless the context otherwise requires, the following terms, when used in the rules contained in this regulation or in Regulation 13A or 15D or in the forms for applications, statements and reports filed pursuant to Section 12, 13 or 15(d) of the Act, shall have the respective meanings indicated in this rule:
>
> (a) *Affiliate.* An "affiliate" of, or a person "affiliated" with, a specified person, is a person that directly, or indirectly through

(Footnote continued on next page)

the TSC board of directors considered the proposed merger transaction and at the time the joint statement was issued, the chairman of the TSC board of directors was Stanley Yarmuth, National's president and chief executive officer, and the chairman of the TSC executive committee was Charles Simonelli, National's executive vice president.

Northway contends that failure to include these facts was misleading since TSC stockholders were relying on the TSC board of directors to negotiate on their behalf for the best possible rate of exchange with National. Because these facts were persuasive indicators that the TSC board was in fact under the control of National, and that National thus "sat on both sides of the table" in setting the terms of the exchange, Northway says these facts were material to a decision whether or not to approve the terms of the transaction as a matter of law. We agree.

While the proxy statement did indicate that five of the ten positions on the TSC board of directors were held by nominees of National and that National held a substantial equity position in TSC amounting to thirty-four percent of outstanding voting securities, this did not render the additional information bearing on National's influence over TSC merely cumulative or trivial. Indeed, there is a vast difference between the picture presented by these facts alone and the picture which would have resulted from the addition of the facts that National nominees occupied the chairmanships of both the board of directors and the executive committee of TSC and that even before the National nominees became TSC board members, both National and TSC

> one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.
>
> (f) *Control.* The term "control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.
>
> (k) *Parent.* A "parent" of a specified person is an affiliate controlling such person directly, or indirectly through one or more intermediaries.

thought it necessary to inform the Securities Exchange Commission that National could be deemed to be in control of TSC.[15] The picture presented in the joint proxy statement may well have indicated to "those aware of the corporate mechanism," *Mills* v. *Electric Autolite Company*, 403 F. 2d 429, 433 (7th Cir. 1968), rev'd on other grounds, 396 U. S. 375, 90 S. Ct. 616, 24 L. Ed. 2d 593 (1970), that National was in a position to exert considerable influence over TSC, but all stockholders, unsophisticated and sophisticated alike, were entitled to the full picture: that a substantial likelihood existed that National's influence in fact amounted to control.

We hold that failure to disclose the prior filings with the Securities Exchange Commission and the failure to disclose the crucial positions held by National nominees Yarmuth and Simonelli on the TSC board of directors were materially misleading within the meaning of § 14(a) of the Securities Exchange Act of 1934 and Rule 14a-9 thereunder as a matter of law. The order of the district court denying summary judgment against the corporate defendants on the issue of liability must therefore be reversed on this ground alone.

B

Northway further contends that the proxy statement was materially misleading in its failure to disclose two sets of facts relating to the favorability of the terms of the proposed merger transaction to TSC shareholders. The first omission involves a series of acquisitions of National Industries Common stock by National and by Madison Fund, Inc., a large mutual fund, during the two years immediately preceding the issuance of the proxy statement. The second omission involves a reference in the statement to an opinion letter from Hornblower &

15. National filed its Schedule 13D on February 14, 1969. TSC filed its Form 10-K on February 27, 1969 and its Form 8-K on March 7, 1969. The election of officers of the TSC board of directors took place on March 31, 1969.

Weeks-Hemphill, Noyes indicating their favorable evaluation of the proposed transaction, when no similar reference was made to a subsequent letter from that firm which more particularly described the basis for the original opinion and indicated that Hornblower expected the market value of the National Warrants being offered to decline substantially prior to the proposed exchange. We hold that these omissions were also material and in violation of Rule 14a-9.

The joint proxy statement contained a major section entitled "Proposed Agreement to Sell TSC's Assets to National and Liquidation and Dissolution of TSC." The first information which appeared in this section concerned the approval of the proposed agreement by the boards of directors of National and TSC. The shareholders were told that the boards of directors of both corporations believed the proposal to be in the best interests of their shareholders, based in part on "recent market prices of the securities of the two corporations." The shareholders were also informed of the favorable opinion of the Hornblower firm regarding the fairness of the transaction to the stockholders of TSC. Current market values of the securities involved were listed as one of the bases for the Hornblower opinion, with specific reference to a "substantial premium over current market values represented by the securities being offered to TSC stockholders."[16]

16. The Boards of Directors of National and TSC have approved the Agreement and believe that the transactions contemplated thereby are in the best interests of the shareholders of both corporations, who will benefit through the diversified activities of the surviving corporation. In reaching their decision the Boards of Directors of each corporation considered not only recent market prices of the securities of the two corporations, but also the preferred dividend to be paid to the TSC stockholders, the businesses and financial conditions of both corporations and various other factors.

At the request of TSC, the investment banking firm of Hornblower & Weeks-Hemphill, Noyes rendered a favorable opinion as to the fairness to the stockholders of TSC of the terms, set forth below, for the exchange of the shares of TSC for securities of National. The TSC Board considered this opinion in approving the sale. In such opinion, said firm con-

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Following this information the terms of the proposed exchange were set out. According to those terms holders of TSC Series 1 Preferred Stock were to receive .6 share of National Series B Preferred Stock and one National Warrant for each of their shares. Each holder of TSC Common Stock was to receive .5 share of National Series B Preferred Stock and 1.5 National Warrants for each of his shares. One of the characteristics of National Series B Preferred was that each such share would be convertible into National Common Stock. Each National Warrant entitled its holder to purchase one share of National Common at $21.40 per share until October 31, 1978.

By linking the evaluation of the proposed exchange to current market values, the proxy statement invited shareholders to rely on a table of market values which appeared three pages later in that statement. The table included market prices of all of the securities involved in the proposed exchange for 1967, 1968 and 1969 up to November 7, 1969; the closing prices on November 7 were set out separately at the bottom of the same page.[17] By using simple arithmetic, any TSC shareholder could thus determine the apparent premium which would result from the proposed rates of exchange based on the latest market figures. Based on these simple calculations, the premiums disclosed were indeed "substantial" as had been indicated earlier in the proxy statement. Each holder of TSC Series 1 Preferred, which closed on November 7 at $12.00, would be receiving National securities worth $15.23 at that closing, while each holder of TSC

sidered, among other things, the current market prices of the securities of both corporations, the high redemption price of the National Series B Preferred Stock, the dividend and debt service requirements of both corporations, the substantial premium over current market values represented by the securities being offered to TSC stockholders, and the increased dividend income.

17. The November 7, 1969 closing prices were as follows:

National Series B Preferred Stock	$16⅝
National Warrants	$ 5¼
TSC Common Stock	$13¼
TSC Series 1 Preferred Stock	$12

common, which closed at $13.25 on that day, would be receiving National securities worth $16.19.[18]

The shareholders were not told that in a subsequent communication the Hornblower firm had predicted that when issued, the National Warrants involved in the exchange would have declined from the November 7 closing price of $5.25 to a market value of $3.50. Such a disclosure would have reduced the apparent premium being offered TSC shareholders by fifty-four percent for holders of Series 1 Preferred and eighty-nine percent for holders of TSC Common.[19] Both corporations were aware of the likelihood of such a decline. The topic was discussed at the TSC board meeting which considered the proposed liquidation and sale, and the subsequent Hornblower opinion letter was specifically requested by National.

In simple terms, TSC and National had received some good news and some bad news from the Hornblower firm. They chose to publish the good news and omit the bad news. Thus, TSC shareholders who relied on the joint proxy statement were led to believe that Hornblower considered the current market values disclosed in the proxy to be accurate indicators of the

18. Each holder of TSC Preferred would receive .6 National B Preferred (.6 × $16⅝ = $9.98) plus one National Warrant ($5.25) or a total value of $15.23 for his $12 TSC Preferred share; each holder of TSC Common would receive .5 National B Preferred (.5 × $16⅝ = $8.31) plus 1.5 National Warrants (1.5 × $5.25 = $7.88) or a total value of $16.19 for each of his $13.25 TSC Common shares. Thus, the apparent per share premiums would be $3.23 and $2.94, respectively.

19. The holders of TSC Preferred, whose apparent premium had been $3.23 per share, would have to deduct the difference between the market value disclosed and the Hornblower adjusted value of National Warrants, or $5.25 − $3.50 = $1.75. Their premium would therefore be reduced by 54% from $3.23 to $1.48 per share. The reduction for holders of TSC Common would be greater since their exchange involved 1.5 Warrants per share. Thus, from an apparent premium of $2.94, each holder would have to deduct ($5.25 − $3.50) × 1.5 = $2.63. This equals a total premium diminution of 89% from $2.94 to $.31 per share of TSC Common.

"profit" to be generated by the exchange being proposed. This wasn't true. The materiality of the omission is obvious.

Additionally, stockholders of TSC should have been informed of substantial purchases of National Common stock by National and by Madison Fund, Inc. during 1968-69,[20] and that between the Schmidt acquisition by National on January 31, 1969 and the proxy solicitation on November 12, 1969 these two corporations accounted for 8.5% of all reported transactions in National Common stock. It is not disputed that Mr. Edward Merkle, president of Madison Fund, was a paid consultant of National receiving $12,000 per year[21] for "being available" to National for at least one day per month,[22] nor is

20. During this period, National and Madison acquired approximately 260,000 shares of National Common stock. In addition Madison acquired $2 million in National debentures convertible to common. There is no mention whatever of the Madison purchases in the joint proxy statement, and while the National acquisition of approximately 80,000 shares of National common is reflected in a table entitled "Statements of Consolidated Stockholder's Equity," which appears on page 63 of the proxy statement, and note J to that table, which appears at the bottom of page 69, this disclosure is insufficient under the "equal emphasis" rationale of this court's decision in *Mills* v. *Electric Autolite Company,* 403 F. 2d 429 (7th Cir. 1968) rev'd on other grounds, 396 U. S. 375, 90 S. Ct. 616, 24 L. Ed. 2d 593 (1969). Just as the board in *Mills* "was not free to state its recommendation and opinion favoring the merger without giving similar emphasis to the relationship between the directors and the other party to the bargain," 403 F. 2d at 434, neither were National and TSC free to emphasize and highlight the importance of current market values of National securities at the beginning of the proxy statement and then bury a partial disclosure of material information affecting those values in a barrage of statistics and footnotes fifty pages later.

21. Mr. Merkel's [sic.] original agreement with National provided a salary of $2,500 per year. On October 1, 1968 this figure was raised to $12,000. Two days later, on October 3, 1968, Madison acquired $2 million in National debentures convertible into its common stock.

22. On July 19, 1972, Mr. Merkel [sic.] consented to the entry of an order by the SEC finding in part that he had caused Madison to purchase 182,500 shares of National Common and National convertible bonds in the amount of $2 million without disclosing that he was a salaried employee of National. In re Merkel, SEC Investment Co. Release No. 7280 (July 19, 1972). The consent was given solely for the purposes of settlement, according to the order.

it disputed that the chairman of National's board of directors, Bernard Barnett, was a director of Madison.

The trial judge found that these facts, coupled with the peculiar timing of the National and Madison acquisitions,[23] showed "the opportunity for coordination." 361 F. Supp. at 116. The judge held, however, that while "the inference that might be drawn from [this] evidence might support a finding of corodination, the Court is not free to draw such inferences." *Id.* But the purpose of 14a-9 is to allow the stockholders to draw such inferences as they see fit before their final decision on proxy questions. While we agree that collusion is not conclusively established by the omitted facts, it is certainly suggested. Stockholders contemplating an offer involving preferred shares convertible to common stock and warrants for the purchase of common stock must be informed of circumstances which tend to indicate that the current selling price of the common stock involved may be affected by apparent market manipulations. It was for the shareholders to determine whether the market price of the common shares was relevant to their evaluation of the convertible preferred shares and warrants, or whether the activities of Madison and National actually amounted to manipulation at all. This is the very purpose of disclosure.

We therefore hold that failure to disclose the unfavorable opinion letter from Hornblower and the facts surrounding the National-Madison acquisitions also violated Rule 14a-9 as a matter of law.

23. National and Madison never made purchases during the same week; in individual weeks, the percentages of total reported trading by them ran as high as 66% for Madison and 35% for National. Madison and National purchases were consistently substantial during periods relevant to previous National take-over bids directed to other corporations and their stockholders, and when National Common showed definite signs of weakening on the market.

C

Northway's final claim under 14a-9 is that the proxy statement was materially misleading in its unqualified assertion that the TSC board of directors had approved the proposed liquidation and sale. First, Northway asserts that the proposal was never legally approved under the applicable Delaware law. The district judge found that § 144 of the Delaware Corporation Law[24] covered the approval procedure in this case and that under that section, the approval vote was legally sufficient.[25] In view of our disposition of Northway's other claims

24. DEL. CODE ANN. TIT. 8, § 144 (1969).

§ 144. INTERESTED DIRECTORS: QUORUM.—(a) No contract or transaction between a corporation and one or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which one or more of its directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee thereof which authorizes the contract or transaction, or solely because his or their votes are counted for such purpose, if;

(1) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or

(2) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders; or

(3) The contract or transaction is fair as to the corporation as of the time it is auth rized, approved or ratified, by the board of directors, a committee thereof, or the shareholders.

(b) Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes the contract or transaction.

25. Under normal circumstances, a proposal requiring dissolution would require a majority of the whole board, or in this case,

(Footnote continued on next page)

and in view of the fact that this issue has not been resolved by the courts of Delaware, we decline to reach the question. We do note, however, that Professor Folk, whose article[26] was relied upon by the district judge, has stated that he never intended his article to indicate that the procedure followed by the TSC board would be legally sufficient to adopt a resolution of dissolution and liquidation. It is Professor Folk's opinion that the TSC board never legally approved the proposed resolution under Delaware law.[27]

six votes:

§ 275. DISSOLUTION; PROCEDURE.—(a) If it should be deemed advisable in the judgment of the board of directors of any corporation that it should be dissolved, the board, after the adoption of a resolution to that effect by a majority of the whole board at any meeting called for that purpose, shall cause notice to be mailed to each stockholder entitled to vote thereon of the adoption of the resolution and of a meeting of stockholders to take action upon the resolution.

* * *

DEL. CODE ANN. TIT. 8 § 275 (1969).

26. Folk, *Corporation Law Developments,* 56 Va. L. Rev. 755, 782 (1970).

27. Professor Folk was contacted by letter by Mr. Arnold Shure, attorney for Northway. In his reply letter, dated July 19, 1973 and filed with the district court on July 24, 1973 as Exhibit A to Plaintiff's Reply to Corporate Defendants' Objections Concerning Plaintiff's Motion Under 28 U. S. C. § 1292(b), Professor Folk states:

The question on which you seek clarification of my views is whether the affirmative votes of disinterested directors, comprising less than a quorum of the board of directors, will be sufficient to approve a resolution calling for the dissolution of a corporation when Section 275(a) requires action "by a majority of the whole board." In my view, a resolution of dissolution adopted by less than a majority of the board of directors (even though those directors have no "interest" in the dissolution) is not effective action by the board for purposes of complying with the specific mandate of Section 275(a). I do not consider that the statement in my article implies or suggests that such a resolution has been effectively approved, and, indeed, that the implications of my statement are the other way. It is this issue which I now analyse.

. . . .

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A second facet of Northway's final claim remains. The resolution of dissolution and liquidation was presented to a meeting of the TSC board on October 16, 1969. Attending that meeting were eight of the ten directors who comprised the board at that time. Charles F. Simonelli and Hyman Ullner, both National nominees, were absent from the meeting. The proposal was summarized for the board by Mr. Allan Solomon, another National nominee. A period of discussion ensued and a vote was called. The three National nominees attending the meeting announced that though they felt this was a good proposal, they had been advised by their attorneys not to vote on the matter.[28] Orville E. Peterson, who had just negotiated the sale of his TSC stock to National for cash and notes payable over five years, also abstained in view of this recent sale. The four remaining directors voted in favor of the proposal to liquidate and to sell to National.

Northway points out that the resolution of dissolution and liquidation was thus passed upon by a minority of the entire board and that the resolution never received a simple majority of those present and eligible to vote at the October 16th meeting. They contend that these facts are so unusual that even if Delaware law allows such a procedure, the stockholders would want to know that the proposal received only four affirmative votes and that those interested directors who could have voted were cautioned against doing so by their legal advisors.

My position is that Section 144 of the Delaware Corporation Law does not state rules as to formal effectiveness of action by a board of directors. It states rules as to when formally effective action may or may not be challenged because of a conflict of interests. To be specific, Section 275 declares the formalities necessary to adopt an effective resolution of the board of directors calling for dissolution of a corporation. That formality is approval "by a majority of the whole board." Section 144(a)(1) does not undercut this statutory requirement for effective action by the board of directors. The role of Section 144, in my judgment, is to predict and determine when formally effective action under Section 275(a) will be held valid or voidable, under Section 144, as the case may be, because of an alleged conflict of interests.

28. Messrs. Segell, Solomon and Yarmuth.

While we agree that the passage of an extraordinary resolution by four affirmative votes out of a total of ten board members is highly unusual, we do not think that this, standing alone, is the type of information which is clearly relevant to a shareholder's decision to approve the underlying proposal. We further believe that reasonable minds could differ on the question of whether or not a reasonable shareholder might consider this information important to his decision. Such information is not related to the substance of the liquidation and sale proposal as is information which reflects on the market value of securities involved nor is it as suggestive of self-dealing as is information related to possible control relationships between the participating corporations. Without other facts, this information may only indicate that those who favored the transaction but felt a possible conflict did not wish to taint the vote of the disinterested board members who also approved of the proposal. The materiality of this omission is not properly determined on motion for summary judgment.

III

The Schmidt defendants are charged with violations of § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5[29] thereunder, and with aiding and

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29. Rule 10b-5, 17 C. F. R. § 240.10b-5, provides:

It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made not misleading, or

(3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

abetting the corporate defendants in the various fraudulent activities charged against them in the plaintiff's complaint.[30]

Count III of the complaint sets out the following wrongful acts upon which recovery from the Schmidt defendants is sought:

> (a) Said defendants failed to have included in said agreement, and failed to make any effort or attempt to have included therein, any terms or provisions to insure that National would not acquire or attempt to acquire complete ownership of TSC, except at a price and on terms at least equal to and not less favorable than those accorded by National to the Schmidt defendants.
>
> (b) Said defendants failed to have included in said agreement, and failed to make any effort or attempt to have included therein, any terms or provisions to insure that National would not utilize its control of TSC to its own exclusive advantage and to the detriment of TSC and its independent stockholders.
>
> (c) Said defendants transferred actual or working control of TSC to National, and aided and abetted National in acquiring complete ownership of TSC for newly issued equity securities at a fraudulently low and grossly inadequate consideration and at a price and on terms which were substantially less favorable to TSC and the independent stockholders of TSC than those accorded the Schmidt defendants, and which were otherwise grossly unfair to TSC and the independent stockholders of TSC.
>
> (d) Said defendants transferred their shares of TSC to National in a manner which resulted in their receiving a substantially higher price for their shares than was received by the independent stockholders of TSC, which higher price was payable in cash and notes of National which were senior to the substantially less valuable equity securities of National received by the independent stockholders of TSC and which would be payable to said Schmidt defendants wholly or partly out of the earnings and cash flow of TSC.

30. In addition to the proxy violations discussed above, the corporate defendants were charged with pursuing various fraudulent activities aimed at securing an unfair advantage over the TSC shareholders in violation of Rule 10b-5. All of the alleged fraudulent activities took place after the acquisition of the Schmidt interests by National.

> (e) Said defendants in disposing of and transferring, actual or working control of TSC to National, wrongfully used and employed said actual or working control to their own exclusive benefit and to the detriment and injury of TSC and its independent stockholders, and failed to exercise due and proper care and diligence to protect the interests of TSC and its independent stockholders.

The trial court properly found that the first two specific alleged violations, (a) and (b), fail to state a claim. Although it is clear that a stockholder who holds a controlling interest in a corporation owes a fiduciary duty to protect the corporate interests and to avoid exhaulting his own interests above those of the corporation or its other shareholders,[31] that recognized obligation is not without reasonable limitations. No court has yet intimated that the holder of a controlling interest must indemnify all other shareholders from adverse market trends in order to fulfill his obligations to those shareholders in transferring control.[32] Nor has any court ever required the inclusion in such a bargain of a covenant by the acquiring party not to do what the law already prohibits. The mandatory inclusion of either such covenant would have far reaching and unfortunate effects. The first requirement would make the transfer of controlling interests almost impossible since no prudent investor, conglomerate or otherwise, would presume to guarantee any specific price for future acquisitions of a fluctuating security. The second requirement would do more to demean the fiduciary concepts here involved than to preserve them since any such provision, if judicially imposed, would merely become boilerplate in all prudent stock purchase agreements. These two specific claims were properly stricken.

31. *See e.g., Pepper* v. *Litton*, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281 (1939), *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919), *Lebold* v. *Inland S. S. Co.*, 82 F. 2d 351 (7th Cir. 1936).

32. *Percodani* v. *Rikes-Maxson Corp.*, 50 F. R. D. 473, 475, 478 (S. D. N. Y. 1970), on which Northway relies, does not suggest such a *requirement.*

Specific allegation (c) charges the Schmidt defendants with aiding and abetting the corporate defendants in the fraudulent acquisition of the remaining securities of TSC. Since there is nothing in the record to indicate that any of the Schmidt defendants had any contact with either National or TSC subsequent to the transfer of the Schmidt interests on or about February 7, 1969, the basis for such a charge must find support in the limited contacts between National representatives and Charles E. Schmidt, Sr. in the brief period between January 6, 1969, when Mr. Schmidt first became aware of National's interest, and the execution of the stock purchase agreement on January 30, 1969.

An examination of the relevant portions of the record reveals no suggestion that Schmidt in any way facilitated the fraudulent take-over by National other than by selling the Schmidt interests to National. This, standing alone, does not constitute aiding and abetting. There is no indication that any one of the Schmidt defendants was consciously involved in a scheme to procure a premium for control, or that any of these defendants were on constructive notice that National intended to commit a fraud in any future transaction. The evidence is all the other way. An investigation of National Industries and its executive personnel initiated by Schmidt did not disclose any prior fraudulent activities by National, and the Schmidts were assured by reliable sources that the National people were top flight in every respect. Under these circumstances there is simply no connection between the Schmidt defendants and National's later activities, and there is certainly no hint that the Schmidts in any way anticipated, or could have anticipated, the use of a fraudulent proxy statement.

As the trial court pointed out, each of the cases relied upon by Northway is distinguishable from the present situation. In each of those cases there was an involvement contemporaneous with and essential to the fraud. In *Brennan* v. *Midwestern United Life Insurance Company*, 417 F. 2d 147 (7th Cir. 1969),

cert. denied, 397 U. S. 989 (1970), Midwestern had failed to report complaints they received about the activities of a stockbroker to the Indiana Securities Commission when circumstances indicated a clear possibility of misuse of Midwestern's Securities by that broker. It was specifically found that

> Midwestern's actions amounted to a tacit agreement with [the broker] to prevent complaints from reaching the Commission, thus facilitating the fraud and allowing [the] scheme to continue to Midwestern's benefit. *Id.* at 155.

The allegations reviewed in *Buttrey* v. *Merril Lynch, Pierce, Fenner & Smith*, 410 F. 2d 135 (7th Cir. 1969), *cert. denied*, 396 U. S. 838 (1969) disclosed a similar situation:

> Here it is alleged that defendant knew or should have known of the bankrupt's scheme to convert securities investment funds and nevertheless enabled the bankrupt to engage in large-scale speculations with its customers' funds through defendant's office. . . . [W]e are persuaded that Count II sufficiently alleges that defendant benefited by a course of business which operated as a fraud upon the bankrupt's customers to entitle those customers, through the trustee in bankruptcy, to recover the net transfers of the funds so converted. *Id.* at 144.

Our opinion in *Carroll* v. *First National Bank of Lincolnwood*, 413 F. 2d 353 (7th Cir. 1969), *cert. denied*, 396 U. S. 1003 (1970) merely held that a complaint which charged that the defendant bank was a "main participant in a scheme to defraud by active concealment of that scheme" stated a claim on the theory of aiding and abetting. Finally, in *SEC* v. *First Securities of Chicago*, 463 F. 2d 981 (7th Cir. 1972), *cert. denied*, 409 U. S. 880 (1972), we held that First Securities had aided and abetted its president in defrauding various of its regular clients by holding him out as a successful investment counsellor and then wilfully allowing him to enforce a rule prohibiting anyone from opening his mail—a rule which prevented the discovery of his fraudulent scheme during its operation. Clearly the involvement disclosed in these cases far

surpasses any involvement of the Schmidt defendants in the take-over, if it could be said there was any involvement.

The trial court correctly found that the exhibits and evidence before it on defendants' motion for summary judgment raised no genuine issue as to any fact which would establish liability under the theory of aiding and abetting.

Specific claim (d) was not separately considered by the trial court in its opinion, but was merged with the discussion of claims (c) and (e). To the extent that this claim relies on the higher compensation received by the Schmidts, the disposition of claim (a) controls here. To the extent that it charges a conscious plan to have the remaining TSC shareholders indirectly bear the burden of an exorbitant compensation for the Schmidt interests, *cf. Dasho* v. *Susquehana* [sic.], 380 F. 2d 262 (7th Cir. 1967), the claim finds no support in the record. There is no evidence of any conscious plan, and the expert witnesses of both plaintiffs and defendants concluded that the Schmidts received no more than market value for their shares.[33]

Specific claim (e), plaintiff's last claim, adds the charge that the Schmidts failed to fulfill their fiduciary obligations to the minority shareholders by making an insufficient investigation of National prior to transferring control.[34] Again, the record fails

33. In March of 1969, at National's request, the firm of Bear, Stearns & Co. evaluated the consideration paid to the Schmidts at $21,053,407.18; the closing prices of the TSC common and preferred stock on the New York Stock Exchange on the date on which the stock purchase agreement was signed were 27⅝ for TSC common and 21⅛ for TSC preferred. These prices produce a total market value of $21,296,224.63 for the Schmidt interests on that day.

Professor Erwin E. Nemmers, Northway's expert witness, testified that the fair market values of the Schmidt interests, on a per share basis, ranged from $29.80 to $36.40 for the common shares and from $22.55 to $27.30 for the preferred shares. By any analysis, the per share consideration received by the Schmidts falls well within these ranges.

34. The control issue itself remains a factual question. Our consideration of this claim assumes that control was in fact transferred by the Schmidts.

to support the claim. It is undisputed that the Schmidt transfer was finalized only after Schmidt, Sr. had 1) analyzed a National prospectus for a recent debenture offering which supplied considerable information about National management, disclosed that National was associated with several highly reputable investment banking firms, and showed that National was able to market debentures at a very favorable interest rate; 2) recognized the names of two highly respected persons on the National board of directors, persons Schmidt felt "would be in a position to do things for and with" TSC; 3) reviewed, with the help of Richard Schaefer, then an executive officer and member of the board of TSC, various financial reports regarding National Industries; and 4) met with top officers of First National City Bank of New York who indicated their bank was well acquainted with National Industries, that the National people were top flight people who always kept their commitments, and that Stanley Yarmuth, president, director, and chief executive officer of National was very highly regarded by First National City Bank.

Northway contends that having discovered no unfavorable information at this point, the Schmidts were obliged to keep digging. There is no suggestion, however, as to what further steps would have been appropriate, other than a rather pointless suggestion that Schmidt should have inquired whether National intended at that point to commit a fraudulent take-over. But the duty to investigate those to whom one transfers a controlling interest in a corporation, like other fiduciary duties, does not exist in a vacuum. It takes its meaning in part from the circumstances in which it is confronted. Thus, in *Insuranshares Corp.* v. *Northern Fiscal Corp.*, 35 F. Supp. 22 (E.D. Pa. 1940), the court emphasized the relation between the scope of the duty of investigation and the setting in which the transfer is made:

> Those who control a corporation . . . owe some duty to the corporation in respect of the transfer of the control

> to outsiders. [S]uch persons may not be wholly oblivious of the interests of everyone but themselves. . . . Without stating any general definition, and stating the duty in minimum terms . . . it may be said that the owners of control are under a duty not to transfer it to outsiders if the circumstances surrounding the proposed transfer are such as to awaken suspicion and put a prudent man on his guard—unless a reasonably adequate investigation discloses such facts as would convince a reasonable person that no fraud is intended or likely to result. Thus, whatever the primary duty may be, circumstances may be sufficient to call into being the duty of active vigilence and inquiry. *Id.* at 25.

In *Insuranshares*, the court found numerous factors which "were sufficient to indicate to any reasonable man in his position that the [purchasing parties] were acquiring the control of the corporation by improper means and for an improper purpose." *Id.*

Although we are unable to read *Insuranshares* as holding that absent suspicious circumstances there is no duty to investigate prior to the transfer of a controlling interest, we agree that the duty in every case is tied to the nature of the peculiar circumstances which exist at the time of such a transfer. We find that the evidence before the trial court in this case presented no facts which would indicate that the Schmidt defendants were under a duty to investigate further than they did. The granting of the Schmidt defendants' motion for summary judgment was therefore proper as to claim (e).

The order of the district court granting summary judgment in favor of the Schmidt defendants is affirmed. The denial of summary judgment in favor of plaintiff Northway and against defendants National Industires, Inc. and TSC, Inc. on the issue of liability is reversed, and the cause is remanded for further proceedings consistent with this opinion.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B.

IN THE UNITED STATES DISTRICT COURT,
For the Northern District of Illinois,
Eastern Division

NORTHWAY, INC., a Delaware corporation,
Plaintiff,
vs.
TSC INDUSTRIES, INC., a Delaware corporation, et al,
Defendants.
No. 69 C 2513

MEMORANDUM OPINION AND ORDER.

This matter arises upon plaintiff's motion for partial summary judgment of liability against the corporate defendants[1] (referred to as "defendants" in Part I below) and the Schmidt defendants' motion for certification pursuant to Fed. R. Civ. P. 54(b) of the order of September 28, 1972,[2] granting summary judgment on Count III of the amended, restated and supplemented complaint.

I.

There is no substantial factual dispute as to the following background. In early 1969, defendant National purchased the Schmidt defendants' interest in TSC, comprising approximately 34% of its outstanding equity securities. After consideration by the TSC board, a proxy statement dated November 12, 1969, (hereinafter referred to as "the joint proxy statement") was sent to the TSC shareholders proposing that TSC sell its assets to

1. TSC Industries, Inc. ("TSC"), National Industries, Inc. ("National"), and TS Liquidating Company.

2. Attached hereto as an appendix.

National, and be liquidated (referred to below as "the transaction"). Sufficient proxies were received for the approval of the proposal.

Plaintiff's instant motion is confined, without waiver of the other charges of the complaint, to alleged violations of § 14(a) of the Securities Exchange Act of 1934, 15 U. S. C. § 78n(a), and the rules promulgated thereunder, in the joint proxy statement. The alleged violations for which plaintiff seeks partial summary judgment as to liability fall into three categories:

A. The inadequacy of disclosure of National's relationship to TSC's management and directors.

B. The misrepresentation of the TSC directors' approval of the transaction.

C. The non-disclosure of facts which would have made the emphasis on market quotations not misleading.

A.

1. Plaintiff first contends that the failure to disclose the change in control of TSC, which had previously been reported to the Securities & Exchange Commission ("SEC"), "constituted a *per se* violation of Rule 14a-3," 17 C. F. R. § 240.14a-3.

Rule 14a-3(a) provides that:

> "No solicitation subject to this regulation shall be made unless each person solicited is concurrently furnished or has previously been furnished with a written proxy statement containing the information specified in Schedule 14A."

Schedule 14A, Item 5, requires:

> "(e). If to the knowledge of the persons on whose behalf the solicitation is made a change in control of the issuer has occurred since the beginning of the last fiscal year, state the name of the person or persons who acquired such control, the basis of such control, the date and a description of the transaction or transactions in which control was acquired and the percentage of voting securities of the issuer now owned by such person or persons."

Plaintiff contends that the joint proxy statement should have stated the conclusion of change of control. As evidence that National was in control of TSC, plaintiff points to one document sent by National and two sent by TSC to the SEC stating that National could be "deemed to be a 'parent' of TSC as that term is defined in the Rules and Regulations under the Securities Act of 1933." Rule 405(n), 17 C. F. R. § 230.405(n), under the 1933 Act, defines a parent as an affiliate "controlling" a person.

Defendants assert that National was not, in fact, in control of TSC within the meaning of Item 5(e), notwithstanding the statements to the contrary in the SEC filings. Rule 12b-2(F), 17 C. F. R. § 240.12b-2(F), under the 1934 Act, and therefore relating to Item 5(e), defines control as "the possession . . . of the power to direct or cause the direction of the management of a person. . . ." Defendants point to the affidavit of Richard Shaefer, the president of TSC, and certain deposition testimony by him and by Stanley Yarmouth [sic.], who was chairman of the board of TSC and president of National at the time of merger, as evidence that National lacked the power to direct or cause the direction of TSC's management. The affidavit and deposition testimony show that Shaefer managed TSC without consulting with or answering to National. This creates an inference, to which defendants are entitled in opposing a motion for summary judgment, that National was not in control of TSC.

Plaintiff cites *Mills* v. *Electric Auto-Lite Co.*, 403 F. 2d 429, 434 (7th Cir. 1968), *rev'd on other grounds*, 396 U. S. 375 (1970), for the proposition that evidence such as that presented by defendants does not preclude summary judgment. The Seventh Circuit held that evidence of the independence of management did not "meet the point presented." The point there was whether the proxy statement was otherwise materially misleading in violation of Rule 14a-9, 17 C. F. R. § 240.14a-9. The situation here is different; such evidence does meet the issue of control presented here by plaintiff's 14a-3 theory.

Thus, viewing the evidence and the inferences therefrom in the light most favorable to defendants, the Court holds that plaintiff has failed to establish the absence of a genuine question of fact as to the material issue of whether National was in control of TSC. Plaintiff's motion for partial summary judgment of liability is accordingly denied as to the Rule 14a-3 ground.[3]

2. Plaintiff also seeks summary judgment of liability on the ground that the joint proxy statement failed, in violation of Rule 14a-9, to adequately disclose the relationship between National and TSC. To establish a violation, plaintiff must prove (a) that the joint proxy statement falsely or misleadingly described the relationship or omitted facts necessary to make the description not false or misleading and (b) that the misstatement or omissions were material in the sense that they "might have been considered important by a shareholder who was in the process of deciding how to vote." *Mills*, 396 U. S. at 374. To establish liability plaintiff must show the additional element of causation. Causation is not disputed here because defendants have admitted in their answer and in response to a request to admit that proxies necessary to the approval of the transaction were obtained from TSC shareholders by the joint proxy statement. *Id.* at 386.

The pivotal question as to plaintiff's motion for summary judgment on this ground is thus whether certain facts relating to the relationship between TSC and National which were omitted from the joint proxy statement were, as a matter of law, material. To meet its burden, plaintiff must show that the facts withheld were so obviously important to TSC shareholders that reasonable minds could not differ on the question of whether the shareholders might have considered them important. *Gould* v. *American Hawaiian S. S. Co.*, 331 F. Supp. 981,

3. The Court has solicited the opinion of the SEC as to whether, if it is shown at trial that National was in control, the joint proxy statement sufficiently disclosed the change of control to satisfy Item 5(e) of Schedule 14A.

986 (D. Del. 1971); *Beatty* v. *Bright*, 318 F. Supp. 169, 173 (S. D. Iowa 1970); *Berman* v. *Thompson*, 312 F. Supp. 1031, 1034 (N. D. Ill. 1970).

Of course, insofar as plaintiff seeks to impose liability for the joint proxy statement's failure to specify that National was in control of TSC, its motion must be denied because of its failure to show the absence of a question of fact as to control.

3. Plaintiff also seeks partial summary judgment on the grounds that the previous *claims* of control made to the SEC should have been disclosed to make the recommendations of the transaction by the TSC mangement and board of directors not misleading.

Pages six and seven of the joint proxy statement set forth under separate headings the approval and recommendations of the National and TSC boards of directors, National's equity interest in TSC and how it was acquired, and National's nominees on TSC's board.

Plaintiff argues that, despite the disclosure of National's equity interest and nominees, the previous claims of control made to the SEC might have been considered important by TSC shareholders faced with the TSC board's recommendation because all except one of the directors who were stated not to be affiliated with National were employees of TSC and thus subject to National's claimed power to direct or cause the direction of TSC's management.

Plaintiff also attacks on the same theory the statement in the covering letter to the shareholders that "management urges you to mark your proxy FOR this purchase of TSC assets. . . ." The allegedly misleading effect of the failure to disclose the prior claims of National's power to direct TSC's management is claimed to have been aggravated by the failure to state that Stanley Yarmuth, the chief executive officer of National, was TSC's chief executive officer as chairman of its board and that Charles Simonelli, executive vice-president of National, was chairman of TSC's executive committee.

Plaintiff relies principally upon the Seventh Circuit's *Mills* decision, *supra; Swanson* v. *American Consumer Industries, Inc.*, 415 F. 2d 1326 (7th Cir. 1969); and *Colonial Realty Corp.* v. *Baldwin-Montrose Chem. Co.*, 312 F. Supp. 1296 (E. D. Pa. 1970), in support of its claim that the disclosure of National's relationship to TSC was inadequate under Rule 14a-9.

The *Mills* opinion (403 F. 2d at 434) and *Swanson* (415 F. 2d at 1330) which relied upon it, establish that the TSC board and management were not free to state their recommendations favoring the transaction without giving similar emphasis to the relationship between them and National. In *Mills*, the court of appeals considered several factors in reaching its determination that the proxy failed, as a matter of law, to adequately bring out the relationship between the Auto-Lite board and Mergenthaler. The Court noted that greater emphasis was given to the Auto-Lite board's recommendation of the merger, through larger and heavier type and placement near the beginning of the proxy statement, than to Mergenthaler's ownership of 54% of the Auto-Lite stock, the number and positions of Mergenthaler nominees on Auto-Lite's board, the fact that all Auto-Lite directors would be on the board of the new corporation, and that two of the Auto-Lite directors who also were directors of Mergenthaler and a third corporation, American, had claimed in a SEC hearing that American controlled the operations of Mergenthaler and Auto-Lite, that seven of Auto-Lite's directors were nominees of Mergenthaler, and that the four remaining Auto-Lite directors were "kept" because of their understanding of the company and their positions in the community. 403 F. 2d at 433-34.

In *Swanson*, decided under Rule 10b-5 rather than 14a-9, Peoria's board recommended that its stockholders vote in favor of the reorganization plan, but failed to disclose that the other party to the bargain, ACI, was the parent of U. S. Cold which it was disclosed would vote its 87% of the shares of Peoria

for the sale, and that the board was composed solely of ACI officers and directors. Based upon this concealment of the board's conflict of interest, the failure to provide an appraisal value for Peoria's assets, the statement that the Peoria stock was relatively worthless, and the concealment of ACI's plan to exploit a corporate opportunity of Peoria, the court concluded that the proxy statements were misleading in material respects and deceptive as a matter of law. 415 F. 2d at 1330-31.

Baldwin-Montrose is a difficult decision. The court there concluded that the joint proxy statement's failure to state that Baldwin-Montrose believed that it had clearly obtained working control of Chris-Craft (which had been stated in an SEC hearing) entitled plaintiff to summary judgment on the issue of liability under §§ 10(b) and 14(a). The *Mills* test for violations of Rule 14a-9 was recited, but no explanation of how the failure to state Baldwin-Montrose's belief made the statements in the proxy statement false or misleading was given. Although the court concluded that the defect was of such a character that it might have been considered important by a reasonable shareholder in the process of deciding how to vote, there was no finding that reasonable minds could not differ on this issue. Further, the court certified its order pursuant to 28 U. S. C. § 1292(b) as involving a controlling question of law as to which there was a substantial ground for difference of opinion. No decision on appeal has been reported, however.

Unlike the proxy statement dealt with in *Mills*, the joint proxy statement complained of here gives similar emphasis to the board's recommendation, National's equity interest in TSC, and the number and some of the positions of National's nominees. If the TSC shareholders were misled as to National's relationship to TSC, the circumstances under which this occurred can hardly be compared to the total concealment of the conflict of interest in *Swanson*. The failure to disclose the prior claim of control for which plaintiff seeks to impose liability was only one of the factors considered in *Mills;* it is not clear that the

Mills court would have held the proxy statement to be in violation of Rule 14a-9 based solely on this omission. The conclusion reached in *Baldwin-Montrose* supports plaintiff's theory, but the lack of analysis, the failure to find that reasonable minds could not differ on the issue of materiality, and the court's willingness to certify the issue for appeal deprive that opinion of much of its value as precedent.

It has been recognized that "[i]t is easy to find small errors and trivial omissions in any proxy statement. . . ." *Allen* v. *Penn Central Co.*, 350 F. Supp. 697, 702 (E. D. Pa. 1972). In passing on plaintiff's motion for partial summary judgment, the Court has considered the omitted facts in light of the manner in which other facts were disclosed which could have alerted the TSC shareholders to the possible bias of the management and board of TSC. *Cf. Kohn* v. *American Metal Climax, Inc.*, 458 F. 2d 255, 267 (3d Cir. 1972). While the Court believes that the prior claims of control made to the SEC and Yarmuth's and Simonelli's other positions might have been considered important by TSC shareholders, it cannot conclude that these facts were so obviously important to them that reasonable minds could not differ on the issue; that is, as to whether they would have a significant propensity to affect the voting process. *Mills*, 396 U. S. at 384. Accordingly, the motion is denied as to this ground.

B.

Plaintiff contends that the statement in the joint proxy statement that the TSC board of directors had approved the transaction was false, in violation of Rule 14a-9. It is admitted that the resolutions to approve the plan of sale, liquidation, and dissolution of TSC were presented to the board at a meeting attended by eight of the ten directors. It is further admitted that directors Noyes, Schaefer, DeForest, and Sharfman voted for the resolutions, that there were no negative votes, and that the remaining directors in attendance, Yarmuth, Solomon, Segell,

and Peterson, did not vote. Plaintiff claims that because the transaction included the dissolution of TSC, its approval required "the adoption of a resolution to that effect by a majority of the whole board . . ." as set forth in § 275(a) of the Delaware Corporation Law, 8 Del. C § 275(a). Defendants argue that § 144, which deals with the validity of the acts of directors where some have adverse financial interests or corporate duties, supersedes § 275 in this situation. Section 144 reads, in pertinent part:

> "(a) No contract or transaction between a corporation . . . and any other corporation . . . in which one or more of its directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board . . . which authorizes the contract or transaction, or solely because his or his or their votes are counted for such purpose, if:
>
> (1) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors . . ., *and the board . . . in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum. . . .*" (emphasis added)

Assuming for the purpose of this motion that directors Noyes, Schaefer, DeForest, Sharfman and Peterson were disinterested, plaintiff asserts that § 144, if it is applicable, was not satisfied. Plaintiff contends that the proper procedure would have been for at least two other directors to have voted for the transaction even though they were interested. Defendants, on the other hand, read § 144 so as to make the votes of interested directors irrelevant so long as a majority vote of the disinterested directors is obtained. There are no reported decisions dealing with the recent amendments to § 144 at issue here. A noted commentator, cited by the parties on both sides, gives the following example of the application of § 144 which supports defendants' view:

> "Thus, if three of four disinterested directors on a nine-man board vote for the transactions, it is validated. In this hypothetical, it is assumed that the five interested directors (who are permitted under these [Delaware] statutes to participate in and vote at the meeting) would have voted for the transaction, so that the resolution formally passes by a vote of eight to one."

Folk, *Corporation Law Developments-1969*, 56 Va. L. Rev. 755, 782 (1970). See also Arsht & Stapleton, *Delaware's New General Corporation Law: Substantive Changes*, 23 Bus. Law. 75, 81 (1967). In the absence of contrary precedent, this construction appears to be reasonable and will be adopted here.

Plaintiff argues that § 144 is inapplicable by its terms to dissolution because it is a unilateral action rather than a contract or transaction between the corporation and others. This technical construction would not serve the apparent intent of the Delaware legislature to abrogate the common law rule of voidness of corporate action where interested directors are present or participate in board meetings. To adopt plaintiff's construction would mean that at least one of the interested directors on the TSC board would have had to make the useless gesture of voting for the transaction when it can be assumed, as in Professor Folk's example, that all of National's nominees would have so voted.

The Court concludes that plaintiff has failed to show that the transaction was not validly approved by the TSC board and accordingly denies its motion for partial summary judgment of liability on that ground.

C.

Plaintiff contends that the joint proxy statement's emphasis on market quotations for the securities to be exchanged was materially misleading as a matter of law under Rule 14a-9, in light of certain undisclosed facts.

TSC shareholders were offered one-half share of National's Series B cumulative preferred stock and one and one-half

National warrants for each of their shares of TSC common and .6 share of National's Series B cumulative preferred stock and one National warrant for each of their shares of TSC Series 1 preferred. Each full share of the National preferred was convertible into .75 share of National common, and each National warrant entitled the holder to purchase one share of National common for $21.40.

On page 10 of the joint proxy statement, in compliance with Item 14(c) of Schedule 14A, the high and low sale prices of National's common stock, Series B preferred stock, and warrants, and TSC's common stock and Series 1 preferred stock for each quarterly period in the preceding two years is set forth. Plaintiff contends that the significance of these market quotations could not be fairly evaluated without disclosure of the fact that National and Madison Fund, Inc. ("Madison") purchased 260,000 shares of National common in 1968 and 1969. Essential to plaintiff's theory is its contention that the purchases by Madison and National were coordinated. It is not disputed that the chairman of National's board of directors, Bernard Barnett, was also a director of Madison and that the president and a director of Madison, Edward Merkle, was employed by National at the time the joint proxy statement was mailed, for $12,000 per year, for performing such duties as requested by National's board for at least one day each month. It has been shown that Merkle consented (solely for the purposes of settlement) to the entry of an order by the SEC finding that he willfully violated and aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q, § 10(b) of the 1934 Act, 15 U. S. C. § 78j(b), and Rule 10b-5 thereunder, and §§ 17(a)(3), 17(d), and 48(a) of the Investment Company Act, 15 U. S. C. § 80a-17(a)(3),-17(d) and-47, and Rule 17d-1, 17 C. F. R. § 270.17d-1, thereunder. This was based in part on the finding that Merkle caused Madison to purchase 182,500 shares of National common and National convertible bonds in the amount of $2

million without disclosing that he was a salaried employee of National, had National common stock and stock options in his personal portfolio, and sold at least 8,100 shares of National common during the period of Madison's purchases. *In re Merkle*, SEC Investment Co. Release No. 7280 (July 19, 1972).

As further evidence that the Madison and National purchases were coordinated, plaintiff notes that neither ever made purchases in the same week as the other and that Madison's purchases "were made at times of substantial benefit to National," such as when the market price of National common was used to fix the exchange ratios in other acquisitions.

In opposition, defendants point to the lack of evidence of any significant purchases of National preferred stock or warrants by National or Madison, the lack of evidence of the relationship of the market price of the National common to the preferred and the warrants, the lack of evidence of purchases by National in the period immediately prior to the mailing of the joint proxy statement, and the lack of evidence that National's and Madison's purchases had any material effect on the market price of National common at the dates given in the joint proxy statement. Defendants also assert, and support with affidavits and deposition testimony, that Yarmuth, Solomon, and Barnett only learned of Madison's purchases of National common after they took place.

Although plaintiff's evidence shows the opportunity for coordination, and the inference that might be drawn from its evidence might support a finding of coordination, the Court is not free to draw such inferences. Thus, defendants' evidence succeeds in raising a genuine issue of fact as to whether the Madison purchases were coordinated with National's. Plaintiff does not argue or cite authority showing that defendants had a duty to disclose Madison's purchases if they were simply aware of, but did not cause, the purchases. Accordingly, plaintiff's motion is denied as to its contention that the purchases of National common by Madison and National should have been disclosed in connection with the market quotations.

Plaintiff also claims that the statement on page 6 of the joint proxy statement that the favorable opinion as to the fairness of the transaction of Hornblower & Weeks-Hemphill, Noyes was based in part upon "the substantial premium over current market values represented by the securities being offered to TSC shareholders. . . ." This assertion is based, first, on the failure to disclose that Hornblower's opinion was predicated on a value of $3.50 each for the warrants, rather than the $5.25 current market price given in the joint proxy statement, and the condition that National retire $13 million of its debt. As to the latter factor, the sentence from which the allegedly misleading statement is taken also includes the statement that the debt service requirements of TSC and National were considered in reaching the opinion. Plaintiff bases its criticism of the failure to disclose that Hornblower relied upon a warrant value of $3.50 on its assertion that the use of this figure results in a very small premium, rather than the substantial one claimed. There is no evidence in the record of which the Court is aware to support this assertion. The truth of this assertion and the adequacy of the disclosure of the condition remain to be determined by the finder of fact and summary judgment on these grounds is thus precluded.

Finally, plaintiff asserts that the statement that Hornblower relied upon a premium over current market values constituted an implicit prediction as to future market values, in violation of Rule 14a-9, as exemplified in Note 1 to the Rule. Note 1 deals, however, with "specific" future market values which clearly were not predicted here. This is certainly not the same type of situation as in *Union Pac. R. R.* v. *Chicago & N. W. Ry.*, 226 F. Supp. 400, 409 (N. D. Ill. 1964), upon which plaintiff relies, where the Northwestern represented that a savings of $25 million was anticipated from a merger and that the value of the package offered by the Northwestern "should reach well above forty dollars per share" as compared with much less for a competing exchange offer. The Court concludes that the

implicit prediction of post-transaction market values here should be governed by the usual standards under Rule 14a-9 rather than upon what would amount to a *per se* test based upon Note 1 to the rule. Accordingly, as plaintiff has failed to show that the implicit prediction was materially misleading as a matter of law, its motion is denied as to this ground.

II.

As the Schmidt defendants correctly point out, this Court's memorandum opinion and order dated September 28, 1972, disposed of the only count in which they are named and in which relief is prayed against them. The Court cannot conclude, however, that there is no just reason for delay in the entry of a final judgment as to that count.

In his often-quoted opinion in *Panichella* v. *Pennsylvania R. R.*, 252 F. 2d 452, 455 (3d Cir. 1958), Judge Hastie noted that Rule 54(b) was adopted to authorize "the exercise of a discretionary power to afford a remedy in the infrequent harsh case [citation omitted]." The only hardships to which the Schmidt defendants claim they will be subjected if plaintiff is not forced to appeal is the additional delay and expense of "sitting through what will obviously be a long and protracted trial against . . . [the corporate defendants]." This is hardly the infrequent harsh case; rather, the inconvenience of which the Schmidts complain is experienced in any case where one or more defendants prevail upon their motions to dismiss or for summary judgment prior to the trial of their codefendants. An appeal of the order granting the Schmidt defendants' motion for summary judgment would only serve to delay the trial of the claims against the corporate defendants by diverting plaintiff's attorneys' energies. Because plaintiff's claims against the Schmidts depend to some extent upon the liability of the corporate defendants, the court of appeals will be presented with a more concrete record upon which to evaluate the propriety of the order of September 28 if the appeal of that order

follows the trial of the remaining issues. The Schmidt defendants have failed to show that the circumstances of this case demand that the strong policy against piecemeal appeals in this circuit, *e.g.*, *Columbia Broadcasting Sys., Inc.* v. *Amana Refrigeration, Inc.*, 271 F. 2d 257, 258 (7th Cir. 1959), *cert. denied*, 362 U. S. 298 (1960), be disregarded in this instance.

Accordingly, the motion of the Schmidt defendants is denied.

IT IS SO ORDERED.

ENTERED:

[s.] R. W. McLaren
United States District Judge.

Dated: May 21, 1973

APPENDIX C.

IN THE UNITED STATES DISTRICT COURT,
For the Northern District of Illinois, Eastern Division.

NORTHWAY, INC., a Delaware Corporation, *Plaintiff,*
vs.
TSC INDUSTRIES, INC., a Delaware corporation, *et al,* *Defendants.*
No. 69 C 2513

MEMORANDUM OPINION AND ORDER.

This matter arises upon the motions of plaintiff and the Schmidt defendants to amend this Court's orders of May 21, 1973 and September 28, 1972, by adding provisions, pursuant to 28 U. S. C. § 1292(b), that such orders involve controlling questions of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the orders may materially advance the ultimate termination of the litigation. For the reasons set forth below, the motions will be granted.

In its May 21 Memorandum Opinion and Order, the Court denied plaintiff's motion for partial summary judgment of liability against the corporate defendants. In so ruling, it was recognized that several disputed questions of law were presented which, if decided in plaintiff's favor, would dictate that the motion should be granted on one or more grounds. In particular, the Court faced a difficult question of first impression under an amendment to the Delaware Corporation Law which goes to the effectiveness of the corporate action which was author-

ized by the shareholders in response to the challenged proxy solicitation. In reaching its decision on this point, the Court relied upon an example given in an article by a noted commentator. Plaintiff has now submitted a letter in which that writer states that the opinion misconstrues his example; he then goes on to explain the law in a manner which results in a conclusion favorable to plaintiff. Although the Court would have considered these views prior to ruling, it maintains its belief that the more reasonable construction is the one adopted in the opinion. The letter serves to point out, however, that there is substantial ground for difference of opinion on the issue.[1]

In its September 28 opinion and order, the Court granted the Schmidt defendants' motion for summary judgment. Certain of the allegations of the complaint were stricken for legal insufficiency, plaintiff having failed to show any authority supporting its position and the Court concluding that Rule 10b-5 should not be extended to provide a claim. On the remaining allegations against the Schmidts, the Court entered summary judgment based upon its reading of the case law in the area of aider and abettor liability. In light of the developing nature of the law in this area and the fact that no decision has specifically rejected plaintiff's theories, a substantial ground for dispute exists.

If the May 21 order is appealed, a reversal of the denial of summary judgment on any of the many grounds asserted will result in liability and may obviate the need for a trial of liability on the remaining grounds. The affirmance of the September 28 order would result in the removal of the Schmidts from this

1. Substantial ground for difference of opinion exists on several other pivotal issues. As a further example, in ruling that materiality could only be resolved in plaintiff's favor on a motion for summary judgment if it was clear that reasonable minds could not differ, it was recognized that no such requirement was imposed, on similar facts, in *Colonial Realty Corp.* v. *Baldwin-Montrose Chem. Co.,* 312 F. Supp. 1296 (E. D. Pa. 1970).

litigation; the reversal of that order prior to the continuation of the litigation in this Court would allow the claims against them to be tried along with those against the corporate defendants, rather than later.

For the reasons set forth above, the Court's May 21 and September 28 orders are hereby amended as of this date to reflect the Court's opinion that they involve controlling questions of law as to which there is a substantial ground for difference of opinion and that an immediate appeal may materially advance the ultimate termination of this litigation.[2]

IT IS SO ORDERED.

ENTERED:

{s.] R. W. McLaren
United States District Judge.

Dated: August 10, 1973

2. Defendant's contentions in regard to the timeliness of the instant motions are without merit. See Rule 5(a), Federal Rules of Appellate Procedure.

APPENDIX D.

SECURITIES EXCHANGE ACT OF 1934, SEC. 14(a), 15 U. S. C. § 78n(a).

§ 78n. Proxies.

(a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title.

SECURITIES AND EXCHANGE COMMISSION, RULE 14a-9, 17 C. F. R. § 240.14a-9

§ 240.14a-9 False or misleading statements.

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

(b) The fact that a proxy statement, form of proxy or other soliciting material has been filed with or examined by the Com-

mission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein or any matter to be acted upon by security holders. No representation contrary to the foregoing shall be made.

NOTE: The following are some examples of what, depending upon particular facts and circumstances, may be misleading within the meaning of this section:

(a) Predictions as to specific future market values, earnings, or dividends.

(b) Material which directly or indirectly impugns character, integrity or personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation.

(c) Failure to so identify a proxy statement, form of proxy and other soliciting material as to clearly distinguish it from the soliciting material of any other person or persons soliciting for the same meeting or subject matter.

(d) Claims made prior to a meeting regarding the results of a solicitation.

SECURITIES AND EXCHANGE COMMISSION, RULE 405(a), (f) and (n), 17 C. F. R. § 230.405(a), (f) and (n).

§ 230.405 Definitions of terms.

Unless the context otherwise requires, all terms used in §§ 230.400 to 230.494, inclusive, or in the forms for registration have the same meanings as in the act and in the general rules and regulations. In addition, the following definitions apply, unless the context otherwise requires:

(a) *Affiliate*. An "affiliate" of, or a person "affiliated" with, a specified person, is a person that directly, or indirectly through

one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

* * * * *

(f) *Control*. The term "control" (including the terms "controlling", "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

* * * * *

(n) *Parent*. A "parent" of a specified person is an affiliate controlling such person directly, or indirectly through one or more intermediaries.

FEDERAL RULES OF CIVIL PROCEDURE, RULE 56(a), (b) AND (c).

Rule 56.

SUMMARY JUDGMENT.

(a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in his favor upon all or any part thereof.

(b) For Defending Party. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.

(c) Motion and Proceedings Thereon. The motion shall be served at least 10 days before the time fixed for the hearing.

The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

APPENDIX.

Supreme Court, U. S.
FILED
DEC 10 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 74-1471

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.), A DELAWARE CORPORATION,

Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Gunthorp-Warren Printing Company, Chicago • Financial 6-6565

PETITION FOR CERTIORARI FILED MAY 23, 1975
CERTIORARI GRANTED OCTOBER 6, 1975

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975.

No. 74-1471

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.), A DELAWARE CORPORATION,

Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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I.

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PLEADINGS IN THE DISTRICT COURT.

12– 4–69	Filed Complaint and two copies with exhibit A attached.
12–26–69	Filed answer of TS Liquidating Company.
1– 5–70	Filed answer of defendant, National Industries to complaint.
9–29–70	Filed Plaintiff's request to admit with exhibit 1 attached.
10–28–70	Filed answer of defendant National Industries, Inc., to request to Admit.
10–28–70	Filed answers of defendant TS Liquidating Company to plaintiff's Request for Admissions.
10–30–70	Filed Answer of Schmidt defendants to plaintiff's request to admit.
1–25–71	Filed Defendants Request for admissions with Exhibits A, B and C attached.
4– 5–71	Filed Plaintiff's revised answers to Schmidt defendants' request for Admissions of January 25, 1971.
4– 9–71	Filed Clerk's file copy of Transcript of Proceedings had before Hon. Hubert L. Will on March 10, 1970. . . *
3– 6–72	Filed Amended, Restated and Supplemental Complaint.

* The correct date is March 10, 1971.

4–10–72 Filed Joint answer of Corporate defendants TSC Industries, Inc., National Industries, Inc., and TSC Industries, Inc., (Formerly named NII, Inc.).

4–11–72 Filed Motion of Schmidt Defendants to dismiss or for Summary Judgment.

6–26–72 Filed Plaintiff's motion for partial summary judgment as to liability of the Schmidt Defendants.

7–31–72 Filed Plaintiff's Motion for Partial Summary Judgment as to Liability of Corporate Defendants.

9–28–72 The court does this day hereby enter its Memorandum Opinion and Order. The Schmidt defendants motion for Summary Judgment is granted. Enter Summary Judgment in favor of the Schmidt Defendants and against the Plaintiff.—Draft—McLaren, J.

5–21–73 The Court does this day hereby enter its Memorandum Opinion and Order. The Plaintiff's Motion for a partial Summary Judgment of liability against the corporate defendants is hereby denied . . . (DRAFT) (see draft for complete details). McLaren, J.

8–10–73 The Court does this day enter its Memorandum Opinion and Order. The Motions of the Plaintiff and the Schmidt defendants to Amend this Court's Order of May 21, 1973 is hereby granted. (DRAFT) (see draft for complete details). McLaren, J.

9–10–73 Filed Certified copy of Order of USCA entered 9-7-73 it is ORDERED that petition for permission to appeal is hereby allowed and further ordered that certified copy be transmitted to USDC.

9–12–73 Filed Bond on Appeal.

UNITED STATES DISTRICT COURT,
Northern District of Illinois,
Eastern Division.

• • • • •

NORTHWAY, INC., a Delaware corporation,
Plaintiff,
vs.
TSC INDUSTRIES, INC., a Delaware corporation, NATIONAL INDUSTRIES, INC., a Kentucky corporation, and TSC INDUSTRIES, INC. (formerly named NII, INC., and being the successor to the business, assets and corporate name of the said TSC INDUSTRIES, INC.) a Delaware corporation, CHARLES E. SCHMIDT, DOROTHY F. SCHMIDT, RICHARD L. SCHMIDT, CHARLES E. SCHMIDT, JR., CHARLES E. SCHMIDT AND DOROTHY F. SCHMIDT FAMILY FOUNDATION,
Defendants.

Civil Action
No. 69 C 2513.

JOINT ANSWER OF CORPORATE DEFENDANTS TSC INDUSTRIES, INC., NATIONAL INDUSTRIES, INC., AND TSC INDUSTRIES, INC. (FORMERLY NAMED "NII, INC.").

• • • • •

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[1] *JOINT ANSWER OF CORPORATE DEFENDANTS*

Pursuant to Rules 8 and 12 of the Federal Rules of Civil Procedure and General Rule 9(a) of this Court Defendants TSC Industries, Inc. (whose corporate name was changed to TS Liquidating Company), National Industries, Inc. and TSC Industries, Inc. (formerly named NII, Inc.), collectively referred to herein as "Corporate Defendants," jointly answer the Amended, Restated and Supplemental Complaint as follows:

Count I

As and for its first Count, Plaintiff complains of defendants TSC, National, and NII, Inc., and alleges as follows:

1. This Court has jurisdiction of this action under Section 27 of the Securities Exchange Act of 1934 (15 USC Section 78aa).

Answer:

Corporate Defendants admit that Plaintiff seeks to invoke the jurisdiction of this Court under Title I, Section 27 of the Securities Exchange Act of 1934 (15 USC Section 78aa), but deny they have any liability created by that Title or rules or regulations thereunder.

[2] 2. Plaintiff, Northway, Inc., is a Delaware corporation licensed to do business in Illinois and having its principal place of business in Chicago, Illinois. Plaintff is and has been the beneficial owner of shares of Common Stock of TSC at the times of the transactions of which plaintiff complains in this action and at all other times material hereto.

Answer:

Corporate Defendants admit the allegations of Paragraph 2.

3. At the commencement of this action and at all material times prior thereto, TSC was a corporation organized under the

laws of the State of Delaware and maintained its principal office in Chicago, Illinois. It operated a successful and profitable business as a retail merchandiser with 221 locations throughout the United States. TSC's Tractor Supply Division sold parts and accessories for farm machinery and various other products for farm use through 173 retail locations in 28 states. TSC's Community Division sold general merchandise and sporting goods through 48 retail locations in six states. In the fiscal year ended October 31, 1968, TSC earned approximately $3.8 million on sales of $165 million. On or about December 5, 1969, the corporate defendants purported to change the corporate name of TSC to TS Liquidating Company, and to transfer the business, assets and operations of TSC to defendant NII, Inc., a wholly owned subsidiary of National which was incorporated under the laws of Delaware for the purpose of taking over the assets and business and carrying on the operations of TSC. Subsequently, the corporate name of said wholly owned subsidiary was changed from NII, Inc., to TSC Industries, Inc., but for purposes of this Complaint said wholly owned subsidiary is referred to herein as NII, Inc. From and after December 6, 1969, the business and operations of TSC have been and are carried on in the same name by said NII, Inc. At the commencement of this action and at all material times prior thereto, TSC was licensed [3] to transact business in the State of Illinois and transacted business in the Northern District of the State of Illinois, Eastern Division. From and after December 6, 1969, said NII, Inc. has continued to transact business therein with its principal office in Chicago, Illinois.

Answer:

Corporate Defendants admit the allegations of Paragraph 3, except to the extent that the term "purported" is intended to indicate illegal, improper or ineffectual action or conduct, which is denied. Further answering, Corporate Defendants aver that at pages 37-44 of the Proxy Statement (Complaint Exhibit A) there is a more complete statement of the business and properties of TSC.

4. Defendant National is, and at all times material hereto was, a corporation organized under the laws of the State of Kentucky and maintains its principal office in Louisville, Kentucky. National is a conglomerate engaged through subsidiary companies in diverse businesses including retailing, manufacturing and distributing diverse products. Among its diverse products are soft drinks, dairy products, laboratory furniture, crude oil and natural gas, sporting goods, general merchandise, toys and processed steel. Since approximately 1963, when present management became associated with it, National has expanded its operations through acquisitions and the development of acquired businesses.

Answer:

Corporate Defendants admit the allegations of Paragraph 4 are substantially accurate and aver that at [4] pages 24-37 of the Proxy Statement there is a more complete statement of the business and properties of National.

5. On October 24, 1969, National had outstanding:

(a) 137,829 shares of National Series A Preferred Stock;

(b) 181,320 shares of National Series B Preferred Stock;

(c) 6,614,041 shares of National Common Stock;

(d) warrants to purchase 650,000 shares of National Common Stock;

(e) employee options to purchase 328,000 shares of National Common Stock; and

(f) contingent obligations to issue 246,000 shares of National Common Stock on account of prior acquisitions.

At all times material hereto, National's Series B Preferred Stock and Common Stock were registered for trading on the New York Stock Exchange and warrants to purchase its Common Stock at $21.40 per share were registered for trading on

the American Stock Exchange. National also had outstanding on a consolidated basis at August 31, 1969, approximately $20 million in short term debt in notes payable primarily to banks; $44 million in long term debt; and $31 million additional subordinated debt convertible into 1,262,000 shares of National Common Stock.

Answer:

Corporate Defendants admit the allegations of Paragraph 5.

[5] 6. On October 24, 1969, TSC had outstanding:

(a) 951,513 shares of $.70 Cumulative Convertible Stock (preferred as to dividends), Series 1 ("TSC Preferred Stock"); and

(b) 1,852,603 shares of TSC Common Stock.

Each share of said stock (regardless of class) entitled the holder to one vote. There were no cumulative voting rights. At all times material hereto, TSC's Preferred Stock and Common Stock were registered for trading on the New York Stock Exchange.

Answer:

Corporate Defendants admit the allegations of Paragraph 6, and further answering aver that TSC had outstanding on a consolidated basis at August 31, 1969, approximately $7 million in short term debt in notes payable primarily to banks and approximately $18 million in long term debt.

7. Pursuant to an agreement dated as of January 30, 1969, copy of which (including the supplement thereto dated February 6, 1969) is attached hereto as Exhibit B:

(a) National acquired from defendant Charles E. Schmidt and the other Schmidt defendants, a total of 434,682 shares of TSC Common Stock for cash and National's notes totalling $13,040,460 ($30 per share) and 439,675 shares of TSC Preferred Stock for cash and National's notes totalling $9,892,-

687.50 ($22.50 per share). The total of $22,933,147.50 was payable one-fourth in cash and the balance in National's 5% notes payable in six annual installments. As additional consideration under the agreement National transferred to said Schmidt defendants warrants to purchase a total of 125,000 shares of National Common [6] Stock during the year commencing February 7, 1974 at $24 per share.

(b) In addition to said TSC shares National received from each of the Schmidt defendants irrevocable proxies with respect to said shares, at the closing under said agreement at Chicago, Illinois, on February 7, 1969. Defendant Charles E. Schmidt tendered his resignation as a director of TSC at the execution of said agreement on January 30, 1969, and his son, defendant Charles E. Schmidt, Jr., tendered his resignation as a director of TSC on February 7, 1969.

Answer:

Corporate Defendants admit the allegations of Paragraph 7.

8. Up to the time of said transaction and at all material times prior thereto, defendant Charles E. Schmidt, individually, and the Schmidt defendants, possessed, directly or indirectly, the power to direct or cause the direction of the management and the policies of TSC, and had actual or working control of TSC, including control of TSC's proxy machinery, the power to designate the management slate of directors and all officers of TSC, and the power to dominate and determine its business affairs and operations. By virtue of said transaction, defendant Charles E. Schmidt and the other Schmidt defendants transferred to National, and National acquired, the power to direct or cause the direction of the management and policies of TSC, actual or working control of TSC, and control of TSC's proxy machinery, the power to designate the management slate of directors and all officers of TSC, and the power to dominate and determine its business affairs and operations.

Answer:

Corporate Defendant deny the allegations of Paragraph 8 of the Complaint and, further answering, aver [7] that the alleged actual or working control of TSC, including control of TSC's proxy machinery and power to designate the management slate of directors alleged to have been enjoyed by Charles E. Schmidt, individually, and the Schmidt defendants, were not transferred or transferable to National and National did not obtain any power to direct or cause the direction of the management and policies of TSC or any actual or working control of TSC or any control of TSC's proxy machinery or a power to designate or influence the management slate of directors or officers of TSC as a result of its aforesaid purchase of TSC stock.

9. At the time of said Schmidt transaction, National was in search of additional acquisitions in furtherance of its then existing program of acquiring complete ownership of businesses wherever feasible. In furtherance of and to implement this program National engaged in the following activities among others:

(a) National's acquisition of said shares of TSC from the Schmidt defendants was made pursuant to and in furtherance of this program and with the intention of acquiring complete ownership of the business of TSC. At the time of said Schmidt transaction, there was no reasonable prospect that National would be able to pay for the remaining outstanding Common and Preferred shares of TSC or its assets and business on the same price and terms, and in the same forms of consideration as accorded the Schmidt defendants.

(b) Among other types of acquisition transactions which it utilized, National first acquired a substantial or controlling interest in the target businesses [8] or companies for cash, notes or debt obligations, and subsequently proceeded to acquire the remaining interests in said businesses or companies and to obtain complete ownership thereof in exchange for National's common stock, warrants to purchase National's common stock

or its preferred stock convertible into its common stock. During 1968 and 1969 National engaged with a large investment company, Madison Fund, Inc. (Madison), in a multi-million dollar series of coordinated purchases of National Common Stock, including substantial purchases at critical times in relation to National's sale of debentures convertible into its common stock and in connection with certain merger transactions in which the amount of National's equity securities to be issued was dependent on the quoted market prices of National Common Stock, and including substantial purchases in 1969 up to the eve of the transaction complained of herein under which National purchased the assets, business, and properties of TSC in exchange for National B Preferred Stock convertible into National Common Stock and warrants to purchase National Common Stock as more fully described in Paragraphs 11 through 16 of this Count I. Said purchases of National Common Stock by National and Madison as more fully described in Paragraph 14(n) of this Count I tended, directly and indirectly, to support the quoted market prices for said National equity securities and to create actual or apparent active trading in said securities.

Answer:

Corporate Defendants deny the allegations of Paragraph 9, except Corporate Defendants admit that at the time of the Schmidt transaction, National was pursuing a program of acquiring equity interests in operating businesses and that prior to December, 1969, National had acquired complete ownership of certain operating businesses by first acquiring a substantial or controlling interest [9] therein for cash, notes or debt obligations and subsequently acquiring the remaining interests in such businesses by further purchase, merger or consolidation for a consideration per share greater than that given per share on acquisition of the substantial or controlling interest. Further answering, Corporate Defendants aver that at the time of the Schmidt transaction there was, in fact, an ability on the part of National to pay for the remaining outstanding common and preferred shares

of TSC or its assets and business on the same pricing formula and terms agreed to with the Schmidt defendants, if such pricing formula and terms would be or become suitable and fair at a future point in time.

10. After the execution of said agreement of January 30, 1969, National exercised its power to direct or cause the direction of the management and policies of TSC and exercised actual or working control of TSC, in furtherance of its acquisition of complete ownership of the business of TSC. Included among other acts were the following:

(a) National caused TSC to adjourn its annual meeting of shareholders convened on February 10, 1969, until March 31, 1969, and caused TSC to submit to its shareholders a revised proxy statement for said adjourned meeting. The revised proxy statement proposed a reduced number of directors to be elected (10 instead of 12) and proposed a slate consisting of four nominees of National and six previously slated nominees, five of whom were employed by TSC, and all [10] of whom occupied positions subject to National's influence and control and were retained as nominees at the sufferance and in the interests of National. Shortly thereafter National caused the directors of TSC to enlarge the Board from 10 to 11 members by electing another director named by National. Subsequently, a TSC director who had been held over from the prior Board as an executive employee of TSC was discharged and removed from the Board, and was not replaced.

(b) National caused to be elected to the new Board of Directors of TSC at the March 31, 1969 stockholders' meeting the key executive officers of National, as follows: (i) Stanley R. Yarmuth, then President and Chief Executive Officer of National, a National director, a member of the executive committee of National's Board of Directors, an executive and director of various National subsidiaries, the second largest shareholder of National, and a "parent" of National as that term is

defined in the Rules and Regulations under the Securities Act of 1933, with the power, directly or indirectly, to cause the direction of the management and policies of National; (ii) Charles F. Simonelli, Executive Vice President of National, a director of National and a member of said executive committee; and (iii) Allan B. Solomon, National's Vice President-Corporate Planning and Development, whose primary functions and responsibilities included the formulation and negotiation of acquisition transactions for National.

(c) On March 31, 1969 at the meeting of the Board of Directors of TSC immediately following said stockholders adjourned annual meeting, Yarmuth became Chairman of the Board of Directors of TSC and thus its Chief Executive Officer. He continued in that capacity at all material times thereafter. Also, on March 31 Yarmuth and Simonelli became members of the executive committee of TSC's Board of Directors and Simonelli chairman of said executive committee

(d) National caused TSC to reduce its apparent income from operations as reported to the public and the independent stockholders for the nine-month period ended [11] July 31, 1969: by making substantial extraordinary inventory reductions on its books, arbitrary charges to income for anticipated but unrealized losses on disposition of assets, and charges to current income of the full amount of certain expenses which, under proper accounting practices, should have been amortized over an extended period, all of which were not in accordance with generally accepted accounting principles consistently applied with respect to TSC's operations; by failing adequately to disclose the amount, nature and facts concerning certain factors which materially reduced the aggregate income of TSC for said period as reported to the public and the independent stockholders of TSC; and by failing to disclose the extraordinary and nonrecurring character of such reductions. While sales of TSC for the nine months ended July 31, 1969 increased by almost $15,000,000 compared to the same period in the preceding

fiscal year, its reported net income was reduced by $1,300,000. In the five years prior to National's assumption of control, TSC's annual sales had increased from $65,000,000 in 1964 to $165,000,000 in 1968; its net income had increased from $2,200,000 in 1964 to $3,900,000 in 1968. The drastic reduction in TSC's reported earnings during the nine months ended July 31, 1969 resulted in a precipitous decline in the market prices quoted for TSC's Common and Preferred Stock on the New York Stock Exchange contrary to the trend in quoted market prices for equity securities of other publicly held and traded companies in the same general field of business as TSC, and far in excess of the general decline in the stock market during the relevant period in 1969. The quoted market price for TSC's Common Stock fell from a high of 34½ on the New York Stock Exchange in the fourth quarter of 1968 to 12¾ at November 28, 1969, a loss of 63%. The quoted market price for TSC's Preferred Stock fell from a high of 25⅞ on the New York Stock Exchange in the fourth quarter of 1968 to 11⅞ at November 28, 1969, a loss of 54%.

Answer:

Corporate Defendants deny that National exercised power to direct or cause the direction of the management [12] and policies of TSC or that it exercised actual or working control of TSC after the execution of said agreement of January 30, 1969, and deny that any plan of National for the acquisition of complete ownership of the business of TSC was formulated, developed or acted upon in any way prior to September, 1969.

(a) Corporate Defendants deny the allegations of subparagraph (a) of Paragraph 10 and, with respect to said matters, aver as follows: On February 5, 1969, the Board of Directors of TSC, none of whom were affiliated with National in any way, held a special meeting in Chicago, Illinois, and (i) resolved to recommend postponement of the annual meeting of stockholders of TSC from February 10, 1969 to March 31, 1969; (ii) determined to submit as nominees for election as

directors six named persons who were unaffiliated with National; (iii) decided to submit as many of five persons proposed by National as upon further investigation appeared to be acceptable and available; (iv) authorized representatives of TSC who were not affiliated with National to act as proxies, to prepare proxy materials, and otherwise effect preparations for the aforesaid adjourned meeting of stockholders; and (v) conducted certain other [13] business of the corporation. On or about February 22, 1969, it was learned that one of the nominees proposed by National was unavailable to serve as a director of TSC. On March 7, 1969, a management slate consisting of six nominees unaffiliated with National and four nominees suggested by National was proposed in a revised proxy statement and was duly elected as the Board of Directors of TSC at the shareholders' meeting on March 31, 1969. On May 26, 1969, a fifth director proposed by National was unanimously elected to the Board of TSC. On October 1, 1969, one of the six directors of TSC who was not affiliated with National resigned and was not replaced. At no time prior to December 5, 1969, did the directors proposed by or who were affiliated with National constitute a majority of the Board of Directors of TSC. Corporate Defendants deny that the six directors of TSC who were unaffiliated with National and who were part of the management slate elected to office on March 31, 1969, occupied positions in any way subject to National's influence or control and Corporate Defendants deny that those six directors were retained as nominees at the sufferance or in the interest of National.

[14] (b) Corporate Defendants admit the allegations contained in subparagraph (b) of Paragraph 10 and, further answering, aver that the fourth director nominated and suggested by National for inclusion in the management slate of TSC for its March 31, 1969 shareholders' meeting was Hyman Ullner.

(c) Corporate Defendants admit the allegations in subparagraph (c) of Paragraph 10, except that they deny that Stanley

R. Yarmuth, who became Chairman of the Board of Directors of TSC on March 31, 1969, functioned or acted as its chief executive officer or as an operating officer of TSC at any time.

(d) Corporate Defendants deny the allegations contained in the first sentence of subparagraph (d) of Paragraph 10 and, further answering, aver that the inventory reductions, the charges to income for losses on disposition of assets and the charging against current income of certain other expenses in determining the income from operations of TSC for the nine month period ended July 31, 1969, were undertaken and effected by Richard H. Schaefer and other officers of TSC. Corporate Defendants admit the allegations of the second and third sentences of [15] subparagraph (d) of Paragraph 10, except Corporate Defendants deny that National assumed control of TSC prior to December 5, 1969. Further answering, Corporate Defendants aver that on pages 19-20 of the Proxy Statement there is a complete and balanced treatment of the consolidated statements of income of TSC during the period 1964 through July 31, 1969. Corporate Defendants deny the allegations of the fourth sentence of subparagraph (d) of Paragraph 10, and further answering aver that the decline was consistent with the trend in market prices for equity securities of other publicly held and traded companies in the same general field of business as TSC in the same period of time, and they further aver that the decline was not in excess of the general decline in the price of stocks in the stock market during the relevant period of 1969. Corporate Defendants admit that the prices quoted in the final two sentences of subparagraph (d) of Paragraph 10 are correctly copied from the Proxy Statement and aver that on page 10 of the Proxy Statement there appears a more complete description and illustration of the changes in market prices of the securities of both TSC and National during [16] the period January 1, 1967, through November 7, 1969.

11. Almost immediately after public disclosure of the unfavorable reported earnings of TSC for the nine months ended

July 31, 1969, National substantially formulated the details including the exchange ratios of its plan of acquisition pursuant to which National, without cash outlay or incurring debt to TSC stockholders, would buy from TSC all of its assets, business and properties for newly issued National securities at a fraudulently low and grossly inadequate consideration and on terms that were otherwise grossly unfair to TSC and the independent stockholders of TSC. This proposed plan and transaction involved, among other steps, the following:

(a) TSC would adopt a plan of liquidation and dissolution under which, among other things, substantially all its assets and business, subject to liabilities, would be sold to a wholly owned National subsidiary formed for this purpose and bearing TSC's name.

(b) Each outstanding share of TSC Preferred Stock would be exchanged in the liquidation and dissolution of TSC for .6 share of National's Series B Preferred Stock plus a warrant to purchase one share of National's Common Stock exercisable at $21.40 per share.

(c) Each outstanding share of TSC Common Stock would be exchanged in the liquidation and dissolution of TSC for .5 share of National's Series B Preferred Stock plus one and one-half warrants to purchase shares of National's Common Stock exercisable at $21.40 per share.

(d) The stockholders of TSC would be required to recognize capital gain or loss on the transaction for federal income tax purposes, resulting in a tax saving to National of several million dollars which National expected to realize almost immediately in connection with other pending or contemplated transactions unrelated to TSC, while the independent stockholders of TSC would be denied the benefits of a tax free merger or other beneficial tax [17] treatment.

(e) The aggregate fair value given up by the independent stockholders of TSC in relation to their interest in the assets

and business of TSC compared with the fair value of the National securities to be received by them in liquidation and dissolution of TSC under this plan would result in a loss in value suffered by the independent stockholders of TSC of about $42 million.

(f) Under this plan the independent stockholders of TSC would receive for their shares a substantially lower value and price and substantially less favorable terms than were accorded by National to the Schmidt defendants for each of their shares of TSC, receiving only National B Preferred Stock and warrants instead of cash or debt securities.

Answer:

Corporate Defendants deny the allegations of Paragraph 11, except as expressly admitted below. Corporate Defendants aver that it was not until about September 1, 1969, that National began to formulate a plan and proposed transaction for the acquisition of the assets of TSC by National in exchange for National's warrants and Class B preferred stock on terms that were fair and for a consideration that was fair and adequate for all of the stockholders of TSC.

(a) Corporate Defendants admit the allegations of subparagraph (a) of Paragraph 11.

[18] (b) Corporate Defendants admit the allegations of subparagraph (b) of Paragraph 11.

(c) Corporate Defendants admit the allegations of subparagraph (c) of Paragraph 11.

(d) Corporate Defendants deny the allegations of subparagraph (d) of Paragraph 11 and, further answering, aver that the proposed transaction, when consummated as a taxable transaction for federal income tax purposes, resulted in a taxable loss to some of the shareholders of TSC, including National, and a taxable gain to other shareholders of TSC, the determinative factor for each shareholder of TSC being his cost basis

for the shares of TSC common or preferred stock he held prior to the consummation of the transaction.

(e) Corporate Defendants deny the allegations of subparagraph (e) of Paragraph 11 and, further answering, aver that the aggregate fair value of the National securities received by the shareholders of TSC in liquidation and dissolution of TSC was in excess of the fair value of their proportionate interests in TSC as a going business at the time the transaction was closed in December, 1969.

[19] (f) Corporate Defendants admit that TSC shareholders who participated in the liquidation and dissolution of TSC in December, 1969, and thereby received National securities in exchange for their respective stock interests in TSC did not receive cash or debt securities, nor did they receive a price per share as high as that obtained by the Schmidt defendants upon sale of their shares in January, 1969. Further, answering, Corporate Defendants aver that the market prices of TSC common stock and TSC preferred stock declined materially from January, 1969, to approximately August 15, 1969.

12. In furtherance of its plan to acquire complete ownership of TSC, National caused or accomplished acts and transactions tending to eliminate potential opposition including, among others:

(a) National caused TSC to retain as its legal counsel, in connection with the proposed sale of TSC's assets to National, the same Chicago law firm which had represented National in its acquisition of its TSC shares from the Schmidt defendants, and in other transactions previous to that time, which firm then had a continuing representation as legal counsel for a subsidiary of National on a substantial annual retainer, and had other connections with National and none with TSC.

(b) National purchased for cash and notes aggregating over $1,000,000, the shares of TSC Common Stock owned by Orville E. Peterson, a director of TSC, and members of his

family, on the same day and at the same time as the meeting of the Board of Directors of TSC at [20] which such sale of assets to National was ostensibly approved. Mr. Peterson attended said meeting but abstained from voting with respect to said proposed transaction in view of the special terms of the sale of his stock to National.

(c) National attempted to purchase approximately 79,000 shares of TSC Preferred Stock owned by Alfred and Reed Sandvig, executives of a TSC subsidiary, and their wives, on the same cash and debt terms as it had offered for the Peterson shares of TSC, and on other preferential terms. After negotiations between National and the Sandvigs or their representatives, an understanding or agreement was reached under which an additional 40,000 shares of TSC Preferred Stock were issued to the Sandvigs on special terms on or about October 16, 1969, and the aggregate of approximately 120,000 shares of TSC Preferred Stock thus owned or held by the Sandvigs were thereafter voted in favor of the proposed sale of TSC assets and its liquidation.

Answer:

Corporate Defendants deny the allegations of Paragraph 12, except as hereinafter specifically admitted.

(a) Corporate Defendants deny the allegations of subparagraph (a) of Paragraph 12.

(b) Corporate Defendants admit the allegations of subparagraph (b) of Paragraph 12, except that Corporate Defendants aver that Peterson abstained from voting upon advice of his counsel.

(c) Corporate Defendants admit the allegations of subparagraph (c) of Paragraph 12 and, further answering, [21] aver that Alfred and Reed Sandvig were key executives of SAS, Inc. ("SAS"), an important subsidiary of TSC, whose continued participation in the management and direction of the subsidiary was thought by TSC to be important to TSC and to National;

that Alfred and Reed Sandvig and their wives had been sufficiently successful in the management of SAS so that they had substantially performed their obligation in terms of the net earnings of SAS under the earn-out provision in the agreement under which SAS was acquired by TSC in 1968; and that it was not feasible to have the earn-out provision in favor of Alfred and Reed Sandvig and their wives survive the December 5, 1969, transaction, because once the transaction was closed in December, 1969, there would be no way to distribute additional shares of TSC preferred stock to them in accordance with the terms of the earn-out provision.

13. In furtherance of its plan to acquire complete ownership of TSC:

(a) National caused said plan of sale, liquidation and dissolution of TSC to be presented to, and ostensibly approved by, the Board of Directors of TSC. All of the material terms of said plan were dictated by National without any arms-length bargaining or negotiation between it and TSC or any appropriate representatives on behalf [22] of TSC or its independent stockholders. Said directors, being dominated and controlled by National and subservient to its demands, gave no independent consideration to the terms of the plan. In fact and effect, National sat on both sides of the table.

(b) The resolutions to approve the plan of sale, liquidation and dissolution of TSC were presented to the directors of TSC at a meeting of the directors on October 16, 1969 at which eight of the ten directors of TSC were present. Those resolutions were interrelated and integral parts of the overall transaction described in the joint proxy statement referred to below as Exhibit A, and received the favorable votes of only four of the eight directors of TSC who were present at said meeting when said resolutions were voted upon. Having failed to receive the favorable votes of the directors of TSC as required under Delaware law, the resolutions to approve the sale, liquidation and

dissolution of TSC, all being interrelated and integral parts of said overall transaction, failed of adoption, and all action thereunder was invalid and unlawful.

(c) National caused a special meeting of the stockholders of TSC to be called and held on December 5, 1969, for the purpose of considering and acting upon the aforesaid plan. In connection with said meeting, National caused TSC to issue to its independent stockholders, through the United States mails, a joint proxy statement (issued by both National and TSC) dated November 12, 1969, soliciting the proxies of said independent stockholders to be voted in favor of said plan. A copy of said proxy statement (including the letter of transmittal constituting the cover page thereof and including all exhibits thereto) is attached as Exhibit A to the copy of this Amended, Restated and Supplemental Complaint which is filed with the Court, and is made a part hereof.

Answer:

(a) Corporate Defendants deny the allegations of subparagraph (a) of Paragraph 13. Further answering, [23] Corporate Defendants aver that the plan and the exchange ratio proposed to the shareholders of National and TSC was based upon an independent determination made by Hornblower & Weeks-Hemphill, Noyes and Blancke Noyes, a director of TSC and a partner in that investment banking and securities firm. Corporate Defendants deny that the TSC directors who voted in favor of the proposed transaction at a special meeting of the TSC Board of Directors held October 16, 1969, were dominated or controlled by National or were in any way subservient to its demands. The TSC directors gave independent consideration to the terms of the plan and concluded that it was in the best interest of TSC and its shareholders.

(b) Corporate Defendants deny the allegations of subparagraph (b) of Paragraph 13, except that Corporate Defendants admit that the resolutions to approve the plan of sale, liquidation and dissolution of TSC were presented to the Board of Directors

of TSC at a special meeting held October 16, 1969; the meeting was attended by eight of the ten directors of TSC with directors Ullner and Simonelli being absent; directors Noyes, Schaefer, DeForest and [24] Sharfman voted in favor of the resolutions approving the proposed agreement and the proposed plan of sale and liquidation, there were no negative votes, and directors Yarmuth, Solomon, Segell and Peterson did not vote on the resolutions, although each of the non-voting directors was in attendance during the meeting while the resolutions were adopted.

(c) Corporate Defendants admit the allegations of subparagraph (c) of Paragraph 13 but they deny that National caused the special meeting of stockholders of TSC to be called and held on December 5, 1969, or that National caused TSC to issue the Proxy Statement.

14. The joint proxy statement of November 12, 1969 contained untrue statements of material facts, statements which, at the time and in the light of the circumstances under which they were made were false or misleading as to material facts, and omitted to state material facts necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading, including the following:

(a) The joint proxy statement failed to disclose that on or about February 17, 1969, 10 days after National acquired about one-third of the outstanding voting shares of TSC from the Schmidt defendants, National had reported said transaction to the Securities and Exchange Commission (SEC) in a document required to be filed under Section 13(d) of the Securities Exchange Act of 1934, and had declared therein that "Accordingly, National may be deemed to be a 'parent' of TSC as that term is defined in the Rules and Regulations under the Securities Act of 1933." Said joint proxy statement [25] also failed to disclose that on or about February 27, 1969, 10 days after said filing by National, defendant TSC had declared to the SEC in a document required to be filed under Section 13(a) of said Securities Exchange Act, concerning changes in control, that

"National Industries, Inc. may be deemed to be a 'parent' of [TSC] within the meaning of the rules and regulations of the Securities and Exchange Commission adopted under the Securities Act of 1933."

(b) The joint proxy statement failed to disclose that from or after the acquisition by National of its shares of TSC from the Schmidt defendants National was a "parent" of TSC, and as such possessed, directly or indirectly, the power to direct or cause the direction of the management and policies of TSC. Similarly, the joint proxy statement failed to disclose that from or after said acquisition, National had control of TSC's proxy machinery, the power to designate the management slate of directors and all officers of TSC, and the power to dominate and determine its business affairs and operations.

(c) The joint proxy statement failed to disclose that from or after the acquisition by National of its shares of TSC from the Schmidt defendants, National directed or caused the direction of the management and policies, exercised actual or working control of TSC, controlled TSC's proxy machinery, designated the management slate of directors and all officers of TSC, and dominated and determined its business affairs and operations.

(d) The joint proxy statement failed to disclose certain facts concerning National's actual or working control of TSC including, among other facts, the following:

(1) On March 31, 1969, Stanley R. Yarmuth became the Chairman of the Board of Directors of TSC and its Chief Executive Officer, and continued in that capacity at all times thereafter to and including November 12, 1969, the date on which the joint proxy statement was mailed to the stockholders of TSC. The joint proxy statement disclosed as his only position with TSC that Yarmuth occupied the position of a member of the TSC Board of Directors. With [26] respect to National, the joint proxy statement discloses that Yarmuth was at all times President and Chief Executive Officer of National, a director of

National, a member of the executive committee of the Board of Directors of National, and the second largest shareholder of National. However, the joint proxy statement does not disclose the further fact that Yarmuth could be deemed a "parent" of National as that term is defined in the Rules and Regulations under the Securities Act of 1933, and as such possessed, directly or indirectly, the power to direct or cause the direction of the management and policies of National.

(2) On March 31, 1969, Yarmuth and Charles F. Simonelli became members of the executive committee of TSC's Board of Directors with Simonelli chairman of said committee. The joint proxy statement discloses as Simonelli's only position with TSC, that he occupied the position of a member of the TSC Board of Directors. As the joint proxy statement discloses, Simonelli was the Executive Vice President of National, a director of National, and a member of the executive committee of its directors.

(3) At page 2 thereof, the joint proxy statement states that "except for the holdings by National, so far as is known to the management of TSC, no person owned of record or beneficially more than 10% of the outstanding voting shares of TSC." In fact, no person or entity, other than National, owned beneficially or of record as much as 1% of the issued and outstanding voting shares of TSC, except that:

(i) A trust fund for the benefit of certain employees of TSC, of which Max J. DeForest (a TSC director and Vice President of TSC's Tractor Division), Richard H. Schaefer (a TSC director and President of TSC), and Lawrence W. Schweik (Secretary of TSC) were the trustees, owned approximately 71,000 shares of TSC Common Stock;

(ii) Alfred and Reed Sandvig, both being executive employees of a TSC subsidiary, and members of their family, owned approximately 120,000 shares of

TSC Preferred Stock with respect to which [27] there had been negotiations with National as set forth in Paragraph 12(c) above and subparagraph (m) of this Paragraph 14; and

(iii) Orville E. Peterson, a director of TSC and president of a TSC subsidiary, with members of his family owned approximately 85,051 shares of TSC Common Stock until on or about October 16, 1969 when said shares were purchased by National for more than $1 million in cash and National's notes as set forth in Paragraph 12(b) above and subparagraph (m) of this Paragraph 14.

(4) National caused TSC to retain as legal counsel for TSC in connection with the proposed transaction to sell TSC's assets to National and to liquidate and dissolve TSC a law firm which had close ties with National as more fully alleged in Paragraph 12(a) above and subparagraph (h) of this Paragraph 14.

(5) National caused TSC to discharge its independent auditors and retain as its auditors the same firm of certified public accountants serving National.

(e) At pages 6 and 7 thereof the joint proxy statement named the 10 directors of TSC. Of these, five were described as nominees of National. The proxy statement then stated "The remaining directors of TSC, namely, Mr. Blancke Noyes, Mr. Orville E. Peterson, Mr. Richard H. Schaefer, President of TSC, Mr. Max J. DeForest, Vice President of TSC's Tractor Division and Mr. Carl W. Sharfman, Vice President of TSC are not affiliated with National." The joint proxy statement omitted to state that Mr. Peterson was president of a TSC subsidiary, and that Mr. Sharfman had been discharged as a TSC employee after National acquired control of TSC but was rehired shortly before the October 16, 1969 TSC directors meeting at which the sale of TSC's assets to National was ostensibly approved. The joint proxy statement failed to disclose the facts respecting the relationships between Blancke Noyes and National

which placed him in a conflict-of-interest position in transactions between TSC and National as set forth in subparagraph (j) of this [28] Paragraph 14. In fact all five members of the TSC Board of Directors who were not stated to be nominees of National and who were stated to be "not affiliated with National" were nominated and selected as directors of TSC at the sufferance and in the interests of National, were employed in positions subject to National's influence and control, and occupied a conflict-of-interest position with respect to the proposed sale of TSC's assets to National.

(f) The joint proxy statement, at page 6, stated that the Board of Directors of TSC had approved the plan of sale, liquidation and dissolution of TSC. This statement was false and was also misleading in that the following facts were not disclosed. The only occasion when said transaction was submitted to the directors of TSC for their vote was at a TSC directors meeting held in Chicago, Illinois, on October 16, 1969. Eight of the 10 directors were present at said meeting at the time of the voting on the proposed plan of sale and liquidation, and the two remaining directors, Ullner and Simonelli, were absent. Of these eight directors, only four, namely Blancke Noyes, Richard H. Schaefer, Max J. DeForest and Carl W. Sharfman, voted in favor of the proposed plan of sale and liquidation. Directors Stanley R. Yarmuth, Allan B. Solomon, and Jack Segell, all being associated with National, upon advice of counsel, expressly abstained from voting on the transaction. Director Orville E. Peterson also expressly abstained from voting thereon in view of the special terms of the sale of his TSC stock to National. The resolutions to approve the plan of sale, liquidation and dissolution of TSC, all being interrelated and integral parts of the overall transaction described in the joint proxy statement, having failed to receive the favorable votes of the directors of TSC as required under Delaware law, failed of adoption, and all action taken thereunder was invalid and unlawful.

(g) The joint proxy statement failed to disclose that the terms of the proposed agreement and transaction to sell TSC's

assets to National and to liquidate and dissolve TSC were not negotiated at arm's length by appropriate representatives of TSC and its independent stockholders. In fact, the timing, nature and terms of the transaction [29] were determined and imposed upon TSC and its independent stockholders by National's management, primarily Stanley R. Yarmuth and Allan B. Solomon, without the participation of any officer or executive employee of TSC who was not also an officer, director or executive employee of National. Solomon was then National's "Vice President, Corporate Planning and Development," whose primary functions and responsibilities included the formulation and negotiation of acquisition transactions for National, and has held this position since approximately June, 1968.

(h) The joint proxy statement failed to disclose that TSC was not represented by independent legal counsel in connection with said proposed transaction to sell TSC's assets to National and to liquidate and dissolve TSC, and failed to disclose certain facts concerning the conflict-of-interest position of the Chicago law firm which purported to act as legal counsel for TSC in connection therewith, including the following, among others:

(1) Said law firm was retained by TSC on or about September 18, 1969 at the request of National.

(2) Said law firm had represented National in the acquisition by National of its shares of TSC from the Schmidt defendants, and in certain other transactions, and was legal counsel on a substantial annual retainer from LaSalle National Insurance Company, which was a subsidiary of National until June of 1969.

(3) Said law firm owned 4,000 shares of Common Stock of National, of which part were received as a brokerage commission or finder's fee in a National acquisition, and part at a bargain price.

(4) William J. Friedman, the person whose name heads the list of names in said law firm, was a limited partner in

the securities underwriting firm which obtained a fee in 1968 as the managing underwriter of a public offering of National debentures.

[30] (i) In the joint letter to stockholders which is the first and cover page thereof, the joint proxy statement recited: "Management urges you to mark your proxy FOR this purchase of TSC assets by National and FOR all other action to be taken at the meeting." On the cover page and on page 6 thereof, the joint proxy statement also stated that the Board of Directors of TSC "believe that the transactions . . . are in the best interests of the shareholders of . . ." TSC. These statements, taken together, represented to the independent stockholders of TSC, contrary to the facts, that their management and their directors, acting as such in the exercise of their independent judgment and on the basis of arm's length negotiation by them on behalf of TSC, believed the plan to be beneficial to TSC's stockholders and were therefore recommending its approval. In fact, none of the directors of TSC exercised independent judgment on behalf of and as a director of TSC. In addition, such representations and recommendations were misleading without full disclosure of the relationships between National and TSC, its directors, officers and management.

(j) At page 6 thereof the joint proxy statement stated that "at the request of TSC, the investment banking firm of Hornblower & Weeks-Hemphill, Noyes rendered a favorable opinion as to the fairness to the stockholders of TSC" of the proposed sale of TSC's assets to National. The statement concerning this opinion is followed by a detailed description of relationships between TSC and said firm and its partner, Blancke Noyes, and by the statement that said firm "did not receive a fee for its services." However, the joint proxy statement failed to disclose that this favorable opinion was rendered under Noyes' direction at the request of Stanley R. Yarmuth, stating instead that it was at the request of TSC, and failed to disclose the relationships between said firm and National which placed said firm and

Noyes in a conflict-of-interest position in transactions between TSC and National, including among others:

(1) The joint proxy statement at page 6 made reference to the fact that in March, 1969 said firm acted as the principal underwriter in the public offering of 195,000 shares of TSC Common Stock. [31] However, it was not disclosed therein that said public offering, initiated to sell stock owned by Charles E. Schmidt and his wife, was allowed to proceed through Noyes only by the consent of National after it had acquired its shares of TSC from the Schmidt defendants, and that said firm was thereby enabled to benefit by its share of aggregate underwriting discounts and commissions of approximately $273,000.

(2) In 1968 said firm received a fee of $20,000 for rendering a favorable opinion as to the fairness to the shareholders of Hawthorn-Mellody, Inc. of a proposed merger of Hawthorn-Mellody into National at a time when National had control of Hawthorn-Mellody.

(k) At page 6 thereof, the joint proxy statement affirmatively stated that the TSC directors, in approving and recommending the plan, considered, among other things, "recent market prices of the securities of the two corporations . . ." It was further recited that, in approving the sale, the TSC directors considered an opinion of Hornblower and Weeks-Hemphill, Noyes which opinion, in turn, considered among other things, "the *debt service requirements* of both corporations" and "the current market prices of the securities of both corporations," and *"the substantial premium over current market value represented by the securities being offered to TSC stockholders* . . ." (Emphasis added.) The joint proxy statement failed to disclose certain facts concerning said Hornblower opinion, including the following:

(1) As a condition of rendering said opinion, said firm required National to commit and agree to the liquidation of approximately $13 million of National's indebtedness to

banks. In order to satisfy this requirement, National undertook to commence a program of selling certain of its assets, all with a view to accomplishing this debt retirement on or before April 1, 1971.

(2) In the opinion of said firm the National warrants to be received by the independent TSC stockholders had a value of approximately $3.50 each, and not the $5.25 quoted market price on the American [32] Stock Exchange of the then existing National warrants as set out on page 10 of the joint proxy statement. On the basis of a $3.50 purported market price, these stockholders would not receive a "substantial premium over current market value," and the apparent value of these warrants would be about $4,375,000 less in the aggregate.

(l) At page 9, the joint proxy statement advised the independent stockholders of TSC that the effect of the proposed sale of TSC's assets and liquidation of TSC was such that the stockholders would recognize gain or loss for federal income tax purposes, and that National would incur a capital loss of approximately $9,200,000. The joint proxy statement did not disclose that National had intentionally designed the transaction as one which would be "taxable" rather than "tax-free" to the TSC stockholders in order to produce a tax saving to National which in fact amounted to more than $3 million. Also undisclosed was the fact that National knew or expected when the joint proxy statement was issued on November 12, 1969 that it would be able to realize nearly all of this tax savings almost immediately in connection with other pending or contemplated transactions unrelated to TSC.

(m) The joint proxy statement failed to disclose certain facts covering special favorable treatment of certain large TSC stockholders in connection with National's acquisition of complete ownership of TSC, which treatment was not made available to the other stockholders of TSC. In this connection the joint

proxy statement failed to disclose the following facts, among others:

(1) In connection with National's purchase of 85,051 shares of TSC Common Stock from TSC director Orville E. Peterson and family for more than $1 million in cash and notes referred to at page 6, the joint proxy statement failed to disclose that this purchase was a part of the proposed sale of TSC's assets to National; was carried out after negotiation with Peterson as a means of relieving the Petersons of the unfavorable federal income tax burdens that they would otherwise suffer as TSC stockholders under the plan; [33] and that these negotiations also involved employment contracts and stock options for Peterson and his brother as part of the deal. In addition, it was not disclosed that the closing of this purchase was held on the same day and in the same place as the TSC directors meeting of October 16, 1969 at which the proposed sale and liquidation of TSC were ostensibly approved; and that Peterson was present at the meeting and expressly abstained from voting on the proposed sale and liquidation in view of the special terms of the sale of his stock to National.

(2) The joint proxy statement did not disclose that Alfred and Reed Sandvig, both being executive employees of SAS, Inc., a wholly owned subsidiary of TSC, with their wives, owned approximately 79,000 shares of TSC Preferred Stock acquired pursuant to an agreement dated April 2, 1968 under which TSC acquired all outstanding shares of SAS, Inc. from the Sandvigs; that pursuant to said agreement an additional 40,000 shares of TSC Preferred Stock would be issuable to the Sandvigs, but only over a period of years to and including 1972 and only if the earnings of SAS, Inc. reached certain specified levels in each calendar year during the earn-out period; that prior to said October 16th meeting of the TSC directors, National had offered to purchase the Sandvig shares of TSC on the same

terms as it was offering to purchase said Peterson shares of TSC and on other preferential terms; that after negotiation between National and the Sandvigs an understanding was reached with the Sandvigs pursuant to which all 40,000 earn-out shares of TSC Preferred Stock were issued to the Sandvigs on or about October 16, 1969 on special terms and the aggregate of approximately 120,000 shares of TSC Preferred Stock thus owned or held by the Sandvigs was thereafter voted in favor of the proposed sale and liquidation of TSC.

[34] (n) At page 10 thereof, the joint proxy statement listed stock exchange price quotations for National's then outstanding B Preferred Stock, listed warrants, and the National Common Stock which was the National security underlying these warrants and the National security into which said B Preferred Stock was convertible. Under the proposed plan, the independent stockholders of TSC were to receive newly issued National B Preferred Stock and newly issued warrants having the same terms as the then outstanding counterparts thereof. These stock exchange price quotations for National's Common Stock covered 1967, 1968, and 1969 through November 7, 1969. However, the joint proxy statement failed to disclose certain facts concerning the close ties between National and a large investment fund, Madison Fund, Inc. (Madison), and the multi-million dollar purchases by Madison and National of National's Common Stock during 1968 and 1969 up to immediately before the ostensible approval by TSC's directors on October 16, 1969 of the proposed sale of TSC's assets to National and liquidation and dissolution of TSC. In this regard, the joint proxy statement failed to disclose the following facts, among others:

(1) National had very close connections with Madison Fund, Inc. ("Madison"), a $300,000,000 closed-end investment company and the third largest in the United States. Edward A. Merkle, who was the chief executive officer and a director of Madison, was also a long time

friend of Stanley R. Yarmuth and was employed by National from about August 1, 1967 until approximately July 9, 1970. The terms of Merkle's employment included options to purchase National Common Stock and a salary which was increased on October 1, 1968 to $12,000 per year under an employment agreement that Merkle would "provide at least one day per month as an employee of [National] with such duties as may reasonably be requested by its Board of Directors or officers." Bernard H. Barnett was also a director of Madison, but this fact was not disclosed in the joint proxy statement which shows that Barnett was a director of National, Chairman of National's Board of Directors, and a member of the executive committee of said board; and [35] owner of approximately 229,000 shares of National Common Stock.

(2) During 1969 National (including an employees' retirement fund of its wholly owned Hawthorn-Mellody, Inc. subsidiary) and Madison had made substantial coordinated purchases of National Common Stock from the week ending February 7, 1969 to the week ending October 17, 1969. National acquired its TSC shares from the Schmidt defendants on February 7th and by October 17th the terms of the proposed sale of TSC to National had been worked out and had been ostensibly approved by TSC's Board of Directors. Such purchases were equal to about 8.5% of the total volume traded on the New York Stock Exchange during this period. In many weeks these purchases were equal to a high percentage of total exchange volume traded, with National's purchases being equal to about 78.5% of such volume in one week, and Madison's purchases equal to about 66% in another week. In other weeks their respective purchases equalled between 29% and 47% of such volume. In eleven of the nineteen weeks in which such purchases were made, they exceeded ten percent of trading volume on said exchange. A substantial portion of National purchases were made at prices over the high for the day on date of purchase. National and Madison on several occasions made stabilizing purchases when the price of National common on the NYSE was weak or National announced unfavorable news. These purchases by National and Madison were coordinated, with Madison's purchases being made in weeks when National did not make purchases, and National's being made in weeks when Madison did not make purchases.

(3) The first public announcement of a pending acquisition of TSC by National appeared in the Wall Street Journal on October 7, 1969. In the week preceding this announcement (ending October 3), Madison's purchases amounted to nearly 15% of the trading in National common on the New York Stock Exchange. On each of the three days following the appearance of this story in the Wall Street Journal, Madison purchased [36] National Common. Madison accounted for nearly 18% of trading volume during the week ending October 10, and almost 10% of volume during the week ending October 17. It was on or about October 9th that Noyes agreed to render the opinion referred to at page 6 of the joint proxy statement, and TSC's Board of Directors ostensibly approved the proposed transaction on October 16, 1969.

(4) Madison also made substantial purchases of National Common stock during 1968, including substantial purchases at critical times in relation to National's sale of debentures convertible into its common stock and in connection with certain merger transactions being consummated between National and Crescent Corporation, Cott Corporation, and Hawthorn-Mellody, Inc. in exchange for National's Common Stock, Preferred Stock convertible into Common, and Common Warrants.

(5) During 1969 through the week ending October 17, National and Madison had purchased at least 130,282

shares of National's Common Stock at a cost of about $1,661,809. Madison's 1968 purchases brought the total number of National Common shares purchased to about 228,100 shares at a cost of about $3,795,305. In addition to these purchases, National, in various transactions, acquired or had arranged to acquire another 54,592 shares in 1969, including 13,260 shares from Mr. Simonelli, its Executive Vice President, and another 34,739 shares in 1968, thereby increasing the total number of common shares acquired by Madison and National over said 1968 and 1969 period to approximately 317,431 shares. The joint proxy statement makes no disclosure with respect to these purchases except for the reference at page 63 showing National's purchases of 56,000 common shares during 1968 and the first six months of 1969. National did not dispose of any of its shares so purchased during 1968 and 1969 in market transactions at any time in 1968 or 1969. Similarly, Madison did not sell, trade, or market any of the National common stock which it purchased during 1968 and 1969.

[37] (o) The joint proxy statement failed to disclose certain facts relating to National's financial condition and its ability to service its heavy debt burden, including the following, among others:

(1) National was so heavily indebted that National's own cash flow projections in October 1969 showed that National would not be able to service its debt requirements over the ensuing five-year period out of the projected earnings and operations of National and its consolidated subsidiaries.

(2) The joint proxy statement made reference at page 8 to the fact that under TSC's Loan Agreement with The First National Bank of Chicago it was necessary to obtain the Bank's consent to the proposed sale of TSC's assets to National, and to the three primary requirements imposed

by the Bank before it would consent to the proposed transaction. It was not disclosed, however, that the Bank initially had refused to consent after two of the Bank's representatives made a review of National's financial condition, and that this review was the basis for the Bank's requirements that the business of TSC be maintained in a separate viable subsidiary corporation and that National could not withdraw funds from TSC's business by dividends, loan or otherwise except to the extent that net after tax earnings of TSC's business exceed $2,000,000 in any year.

(p) At page 19 thereof, the joint proxy statement presented an audited Consolidated Statement of Income of TSC for the fiscal years 1964 through 1968, and an unaudited statement for the nine months ended July 31, 1968 and July 31, 1969. For the 1969 period, TSC's stated net income Before Extraordinary Items was reported to have declined approximately 40% compared to said nine-month period in 1968. At the bottom of page 20, this decline in earnings was attributed to the Community Discount Division of TSC, the most significant factors being said to be "markdowns of inventory at July 31, 1969, to give recognition to overstocks and merchandise conditions," "anticipated losses on disposition of certain fixed assets," and "the reflection of nine months of [38] operations at a loss of the Kansas City Stores. . . ." The joint proxy statement, however, did not disclose the amounts of these charges and reductions in TSC's stated income from operations as reported and did not disclose certain other facts relating to the reported earnings of TSC, including the following:

(1) The aggregate effect of the three factors referred to at the bottom of page 20 was to reduce TSC's stated net (pre-tax) Income Before Extraordinary Items as reported on page 19 by approximately $1,300,000 for the nine months ended July 31, 1969. Said apparent income was further reduced by charging against current income for said nine months approximately $62,500 (pre-tax)

in future compensation payments over a period of years under an employment contract with Carl Sharfman who had been discharged and rehired as described in subparagraph (e) of this Paragraph 14. If the amounts and the facts concerning these items had been adequately disclosed and properly accounted for, TSC's net (after tax) Income Before Extraordinary Items would have been reported or disclosed as approximately $2,447,000 for the nine months ended July 31, 1969, and thus nearly equal to the same period in 1968.

(2) It was not disclosed that the amount of said "markdowns of inventory at July 31, 1969," was approximately $254,000 over and above the Community Discount Division markdowns previously taken during the current fiscal year up to July 31; that it was an extraordinary and non-recurring charge, was arbitrarily determined, and was not in accordance with generally accepted accounting principles consistently applied with respect to TSC's operations.

(3) It was not disclosed that included in the losses attributable to the five Kansas City Stores for said period was an extraordinary charge of approximately $366,000 on account of the unexplained absence of inventory over and above the amount normally provided for inventory shrinkage; that this extraordinary inventory shortage was first discovered by TSC management in approximately March of 1969; that management [39] could not determine whether this extraordinary shortage had occurred during the current fiscal year (1969), or during the preceding fiscal year (1968), or in connection with the original acquisition by TSC of the Kansas City Stores in April 1968; that this extraordinary inventory shortage was a non-recurring event; and that such charge against TSC's earnings for the nine months ended July 31, 1969 was not in accordance with generally accepted accounting principles consistently applied with respect to TSC's operations.

(4) It was not disclosed that the amount of the losses attributed to the five Kansas City Stores for said nine months over and above said extraordinary inventory shortage was approximately $518,000; that in view of the continued and mounting losses being experienced in the operations of this group of five stores it was contemplated by management that this group of five stores would be disposed of or otherwise closed in the near future; and that the losses attributed to the operation of the Kansas City Stores could not be considered as arising out of normal and continuing operations of TSC.

(5) It was not disclosed that the amount attributed to said "anticipated losses on disposition of certain fixed assets" was approximately $144,000; that $31,000 of this amount was attributed to real estate being condemned but not yet taken by the City of Chicago after the store thereon had been destroyed in a riot; and that the remaining $113,000 was attributed to fixtures and improvements in a Community Discount Store being considered for closing but which in fact has not been closed; that such charges were extraordinary in nature; and that the charge thereof against the earnings of TSC for said nine-month period was not in accordance with generally accepted accounting principles consistently applied with respect to TSC's operations.

(6) It was not disclosed that approximately $62,500 in future compensation payments to Carl Sharfman [40] over a period of years under his employment contract had been charged against TSC's earnings for said nine-month period in connection with his discharge; that such charge was extraordinary in nature; that it was not in accordance with generally accepted accounting principles consistently applied with respect to TSC's operations; and that said charge had been reversed on TSC's books and eliminated when Mr. Sharfman was rehired in October 1969 before

the joint proxy statement was issued, but the correction was not reflected in TSC's earnings as reported in the joint proxy statement.

(q) By virtue of the references to "recent market prices," "current market value," and "substantial premium over current market values" at page 6 of the joint proxy statement, and the representations in the joint letter to shareholders (cover page) that the directors were of the opinion that the proposed sale was in the best interests of the TSC shareholders and that management urged approval of the transaction, the stockholders of TSC falsely were led to believe, among other things:

(1) That the stock exchange quotations for TSC Preferred and Common Stock as reported on page 10 were a valid measure of the fair value of TSC's assets and business;

(2) That the stock exchange quotations for the National B Preferred Stock, warrants and underlying Common Stock then outstanding and listed for trading as reported on page 10 were a valid measure of the fair value of the National securities, not then outstanding, which were to be received by the independent stockholders of TSC; and

(3) That the transaction was fair and in the best interest of TSC and the independent stockholders of TSC.

(r) The joint proxy statement failed to disclose that the terms of the proposed sale of TSC's assets to National [41] and liquidation of TSC were grossly unfair to TSC and the independent stockholders of TSC and that as a result thereof National would acquire the assets and business of TSC for grossly inadequate consideration. In this connection, the joint proxy statement failed to disclose the following facts, among others:

(1) Under the proposed transaction, the independent stockholders of TSC would give up over $1 million per year in TSC earnings and would receive little or no in-

crease in aggregate dividends on the National B Preferred Stock to be received over the aggregate amount of dividends which were being paid by TSC with respect to their shares of TSC. In order to obtain a position with respect to National's common earnings under the proposed transaction, the independent TSC stockholders would have to convert the National B Preferred Stock to be received into National Common Stock pursuant to the conversion rights provided in said National B Preferred Stock. In so doing these TSC stockholders would give up more than $1.2 million in preferred dividends in return for a position with respect to National's common earnings equal to only about 54.5% to 66.5% of the amount of said preferred dividends and equal to only about 30 to 35% of their own TSC preferred dividends and common stock earnings. In addition, under the proposed transaction, the independent TSC stockholders would contribute about 32.5% of the combined earnings of TSC and National, but would receive dividends equal to only about 18% thereof if they held the National B Preferred Stock to be received by them, and would participate in those combined earnings to the extent of only about 9% of such combined earnings if they converted said National B Preferred Stock into National Common Stock pursuant to the conversion rights under said National B Preferred Stock.

(2) The "Comparative Per Share Data" presented at page 23 of the joint proxy statement was false and misleading. Among other inaccuracies, said data as presented falsely led the independent TSC stockholders to believe that under the proposed transaction they [42] would have both preferred dividends and common earnings attributable to the National securities to be received by them. The per share income figures falsely showed that these TSC stockholders, even without converting the National B preferred stock to be received by them, would share in National common earnings, and these figures were otherwise inaccurate and invalid.

(3) The "Pro Forma Combined Income Summary" presented at page 21 of the joint proxy statement was false and misleading. Among other inaccuracies therein were the following:

(i) That presentation failed to take into account the fact that no part of the earnings from TSC's business would be available in any year to pay dividends on the more than 1 million shares of National's Preferred Stock that would be outstanding as a result of the proposed transaction, except to the extent that TSC's earnings exceeded $2 million in each year. Accordingly, the amount represented to be available for this purpose was overstated by $2 million or about 25%.

(ii) That presentation was based on the combination of the operations of National for the 12 months ended June 30, 1969 and the operations of TSC for the 12 months ended July 31, 1969, instead of the annualized operations of both companies for the year 1969, and did not properly reflect TSC's net income from continuing operations for the nine months ended July 31, 1969 as described in subparagraph (p) of this Paragraph 14. Properly presented and taking into account the $2 million restriction as to TSC's earnings referred to in the foregoing subparagraph (i), this summary would have revealed that after giving effect to the proposed transaction, income from continuing operations available for the payment of dividends on National's preferred stock would be only about $4.8 million, about 40% less than shown on page 21.

[43] (4) The joint proxy statement failed to disclose that the aggregate fair value given up by the independent stockholders of TSC in relation to their interest in the assets and business of TSC compared with the fair value

of the National securities to be received by them in liquidation and dissolution of TSC under this plan would result in a loss in value suffered by the independent stockholders of TSC of about $42 million.

Answer:

Corporate Defendants deny the allegations of the introductory clause of Paragraph 14.

(a) Corporate Defendants deny the allegations of subparagraph (a), except that they admit that the Proxy Statement did not recite that for purposes of the Securities Act of 1933 National could be deemed to be the "parent" of TSC following the acquisition of TSC shares from the Schmidt defendants pursuant to contract of January 30, 1969, a copy of which is annexed to the Complaint as Exhibit B. Corporate Defendants admit that in reporting said transaction to the Securities and Exchange Commission shortly after the transaction was closed on February 7, 1969, both TSC and National recited that National may be deemed to be a "parent of TSC as that term is defined in the Rules and Regulations under the Securities Act of 1933." Further answering, Corporate Defendants aver that while such a recital is suitable in [44] an S. E. C. Form 10K or an S. E. C. Form 13D, it was neither suitable nor material in the Proxy Statement mailed to shareholders of National and TSC on or about November 12, 1971. National and TSC affirmatively and accurately disclosed the precise interest of National in TSC from the time TSC stock was acquired by National from Charles E. Schmidt and other members of the Schmidt family on February 7, 1969, to the date of the Proxy Statement.

(b) Corporate Defendants deny the allegations of subparagraph (b), except that they admit that the Proxy Statement did not disclose that from and after the acquisition by National of its shares of TSC from the Schmidt defendants, National was a "parent" of TSC for purposes of the Securities Act of

1933, which is only relevant where a public distribution of securities is involved. Corporate Defendants aver that National became a significant TSC stockholder upon acquiring the Schmidt shares and, as such, National's nominees were accorded representation on the Board of Directors of TSC on March 31, 1969.

(c) Corporate Defendants deny the allegations of subparagraph (c).

[45] (d) Corporate Defendants deny that the matters not disclosed in the Proxy Statement were material or that their disclosure was required by the Rules and Regulations of the Securities and Exchange Commission:

(1) Corporate Defendants deny the allegations of subparagraph (1), except that they admit that on March 31, 1969, Stanley R. Yarmuth became the Chairman of the Board of Directors of TSC and that he continued in such capacity at all times thereafter to and including November 12, 1969, the date on which the Proxy Statement was mailed to the stockholders of National and of TSC. Corporate Defendants aver that Stanley R. Yarmuth at no time was chief executive officer or an operating officer of TSC. Corporate Defendants admit that the Proxy Statement discloses the directorships and offices in National held by Mr. Yarmuth and that it does not disclose that Mr. Yarmuth could be deemed to be a "parent" of National for purposes of the Securities Act of 1933, but Corporate Defendants aver that no such disclosure was material or required by the Rules and Regulations of the Securities and Exchange Commission.

(2) Corporate Defendants deny the allegations of subparagraph (2), except that they admit that Mr. [46] Yarmuth and Charles F. Simonelli became members of the executive committee of the Board of Directors of TSC on March 31, 1969, and that Mr. Simonelli became Chairman of said committee; that Mr. Simonelli's status as

Executive Vice President of National and a director and member of the executive committee of its Board of Directors were disclosed, although the Proxy Statement did not disclose Mr. Simonelli's status as Chairman of the executive committee of the Board of Directors of TSC on and after March 31, 1969. Corporate Defendants further aver that Messrs. Blancke Noyes, Richard H. Schaefer and Samuel Sharfman were also designated members of the executive committee and that any action of the executive committee required the concurring vote of not less than three members.

(3) Corporate Defendants deny the allegations of subsubparagraph (3), except that they admit that the Proxy Statement correctly indicates at page 2 thereof that, "except for the holdings by National, so far as is known to the management of TSC no person owned of record or beneficially more than 10% of the outstanding voting shares of TSC;" also that the Proxy Statement does not disclose the [47] smaller stock holdings of a TSC Employees Benefit Trust under which Messrs. DeForest, Schaefer and Schweik were trustees or the similar stock interests of Alfred and Reed Sandvig.

(4) Corporate Defendants deny the allegations of subparagraph (4) of subparagraph (d).

(5) Corporate Defendants deny the allegations of subparagraph (5) of subparagraph (d).

(e) Corporate Defendants deny the allegations of subparagraph (e), except that they admit the allegations of the first three sentences of subparagraph (e) and admit that the Proxy Statement did not disclose that Orville Peterson was President of a TSC subsidiary but they deny that Carl Sharfman was discharged as a TSC officer, director or employee and deny he was subsequently rehired shortly before October 16, 1969. Further answering, Corporate Defendants aver that omis-

sion of such information was not material. Corporate Defendants admit that Proxy Statement made no disclosure of an alleged conflict-of-interest position as to Blancke Noyes in reference to transactions between TSC and National and, further answering, aver that no such conflict-of-interest existed.

[48] (f) Corporate Defendants deny the allegations of subparagraph (f) except that they admit that the Board of Directors of TSC approved a plan of sale, liquidation and dissolution of TSC at a meeting held in Chicago, Illinois, on October 16, 1969; that eight of the ten directors of TSC attended the meeting and two directors, Messrs. Ullner and Simonelli, were absent; that four of the directors, namely, Messrs. Noyes, Schaefer, DeForest and Sharfman, voted in favor of a proposed plan of liquidation, and the remaining four directors, namely, Messrs. Yarmuth, Solomon, Segell and Peterson, abstained from voting on the matter on the advice of counsel. Corporate Defendants aver that there were no negative votes, and that all directors of TSC favored the plan.

(g) Corporate Defendants deny the allegations of subparagraph (g), except that they admit the titles and responsibilities of Allan B. Solomon are correctly described in the final sentence of subparagraph (g). Corporate Defendants aver that Richard H. Schaefer, President, and other officers of TSC, took active roles in representing the interests of TSC shareholders in connection with the proposed [49] agreement and transaction and that TSC director Blancke Noyes proposed and negotiated important changes in the plan originally proposed by officers of National resulting in a transaction which was fair to the TSC shareholders in his opinion and that of his firm.

(h) Corporate Defendants deny the allegations of the introductory clause of subparagraph (h).

(1) Corporate Defendants deny the allegations of sub-subparagraph (1).

(2) Corporate Defendants admit the allegations of subparagraph (2) of subparagraph (h) and, further answering, aver that said law firm represented LaSalle National Insurance Company before National had any interest therein and continued to represent it after National ceased to have an interest in the Insurance Company.

(3) Corporate Defendants admit that said law firm owned 4,000 shares of common stock of National in the fall of 1969, part of which was received as a brokerage commission or finder's fee in a National acquisition, but deny that the balance thereof had been obtained at a bargain price.

[50] (4) Corporate Defendants admit the allegations of subparagraph (4) of subparagraph (h).

(i) Corporate Defendants deny the allegations of subparagraph (i) except that they admit the accuracy of the limited verbatim quotation from the joint letter to stockholders which is the cover page of the Proxy Statement.

(j) Corporate Defendants deny the allegations of subparagraph (j) except that they admit the allegations of the first two sentences of the introductory paragraph thereof.

(1) Corporate Defendants deny the allegations of sub-subparagraph (1), except that they admit the allegations of the first sentence of subparagraph (1) of subparagraph (j). Further answering, Corporate Defendants aver that said 195,000 share public offering consisted of 150,000 shares issued by TSC and 45,000 shares owned by members of the Terry family; that said 195,000 shares had been included in a preliminary prospectus which was withdrawn in January, 1969. Further, Corporate Defendants aver that said investment banking firm received only its share of aggregate underwriting discounts and commissions and aver that sum was approximately one-sixth of the aggregate underwriting discount and commission.

[51] (2) Corporate Defendants deny the allegations of sub-subparagraph (2) and aver that the fee was paid by

Hawthorn Mellody, Inc. to said investment banking firm as fair compensation for its services to the shareholders of Hawthorn Mellody, Inc.

(k) Corporate Defendants deny the allegations of subparagraph (k), except that they admit that Hornblower & Weeks-Hemphill, Noyes predicated its opinion not only on the entire number of actively traded, existing National warrants but also those to be issued to TSC shareholders, on the basis of $3.50 per warrant rather than the then-current market price of $5.25.

(l) Corporate Defendants deny the allegations of subparagraph (l), except that they admit the allegations of the first sentence thereof.

(m) Corporate Defendants deny the allegations of subparagraph (m) and aver that the Peterson family and the Sandvig family each constituted a group of TSC shareholders who obtained their respective stock interests in TSC upon transfer of their theretofore independent businesses, Big Bear, Inc. ("Big Bear") and SAS, respectively. The material [52] facts with respect to TSC's acquisition of Big Bear and SAS were fully and fairly disclosed in the Proxy Statement at page 39 under the description of the Tractor Division, as well as in Note D to the TSC financials at page 20 and in Note 10(a) to the TSC financial statements for the nine month period ended July 31, 1969. Corporate Defendants further aver that the sale of the Peterson family stock is fully disclosed on page 6 of the Proxy Statement.

(1) Corporate Defendants aver that the sale, sale price, employment contracts and stock options for Orville Peterson and his brother were undertaken at the insistence of Richard H. Schaefer and other members of TSC management who were aware of the aggressive and successful business operation of Big Bear under leadership of the Petersons and their key employees and reasonably believed that their continued employment by TSC was important to successful continued operation of Big Bear.

(2) Corporate Defendants admit the allegations of sub-subparagraph (2) of subparagraph (m). Further answering, Corporate Defendants aver that the earning performance of SAS since its acquisition by TSC in April, 1968, was sufficient to warrant a conclusion that the selling [53] shareholders of SAS (members of the Sandvig family) were virtually certain to become entitled to the entire issue of earn-out shares under their agreement with TSC; that upon consummation of the transaction between National and TSC in December, 1969, it would no longer be possible for TSC to perform its obligations under the earn-out provisions of the agreement with the Sandvigs; and that members of the Sandvig family rejected a cash offer made by National upon terms identical to those proposed to and accepted by the Petersons and instead elected to retain their TSC shares and, additionally, to receive their earn-out shares and vote favorably upon the sale, transfer of assets, and liquidation of TSC for what they deemed to be their enlightened self-interest.

(n) Corporate Defendants deny the allegations of subparagraph (n), except that they admit the allegations of the first three sentences thereof. Corporate Defendants admit that the Proxy Statement makes no disclosure concerning alleged "close ties" between National and Madison Fund, Inc. (Madison), which allegation is denied, nor any disclosure with respect to the purchases by Madison of the common stock [54] of National. Corporate Defendants aver that the Proxy Statement made full and adequate disclosure of National's transactions in its own securities in all material respects. Separately answering the five numbered sub-subparagraphs of subparagraph (n) of Paragraph 14:

(1) Without admitting that any of the allegations of sub-subparagraph (1) are true, Corporate Defendants admit there is no disclosure of them in the Proxy Statement and aver that no disclosure was required.

(2) Corporate Defendants deny the allegations of sub-subparagraph (2) and deny that National's purchase of National common stock (including the Employees Retirement Trust of Hawthorn Mellody, Inc., a subsidiary of National) were coordinated with Madison in any way or to any degree. Further answering, Corporate Defendants aver that the only open market purchases of its own common stock made by National during the entire year 1969 were the limited number of transactions during the period March 25, 1969, through September 17, 1969, and the two transactions on December 18 and December 23, 1969, all of which are shown (together with daily and monthly trading volume figures) on the attached Exhibit A to this Joint Answer. Further answering, [55] Corporate Defendants aver that the only other transactions made by National or its subsidiaries involving its common stock during the years 1968 and 1969 were non-market transactions which by their very nature had no effect on the market price of National's common stock. Further answering, Corporate Defendants aver that Madison began purchasing the common stock of National Industries, Inc. in March, 1968, and that such purchases continued during the years 1968, 1969 and into the year 1971 but that the total number of shares purchased by Madison during the period September 9, 1969, through December 28, 1969, was 16,200 shares in 11 different transactions scattered through the period. Further answering, Corporate Defendants aver the only market purchase of National Common stock made by a subsidiary or entity related to National during the years 1968 and 1969 was a single purchase of 7,300 shares of National common stock made by the Employees Retirement Trust of Hawthorn Mellody, Inc. on June 18, 1969, at a price of $12.13 per share. Further answering, Corporate Defendants aver that National made its purchases of its own common stock in conformity with the rules of the New York Stock Exchange and rules and

policies of the Securities and Exchange Commission and duly [56] filed reports of such purchases with the Exchange; further, Corporate Defendants aver that National made no purchases of its own common stock in market transactions at prices over the high for the day on the day of purchase, nor did National make any stabilizing purchases of its own securities at any time or coordinate or otherwise relate its purchases with those of Madison at any time.

(3) Corporate Defendants admit the factual matter alleged in sub-subparagraph (3) and, further answering, aver that Madison had become a holder of National common stock in March, 1968, and had continued to increase its holdings by periodic additional purchases from March, 1968, through 1969 and continuing into 1971. Further answering, Corporate Defendants aver it is commonplace for a large mutual fund (often joined by other similar funds) to increase its purchases or to make additional purchases following favorable news concerning the subject company, and it was and is common for mutual funds and other institutions to account for a significant percentage of trading volume in a given week as to a particular security. [57] (4) Corporate Defendants deny the allegations of sub-subparagraph (4) of subparagraph (n) except that they admit that Madison made purchases of National common stock during 1968.

(5) Corporate Defendants deny the allegations of sub-subparagraph (5) of subparagraph (n), except that they admit that during 1969 through the week ended October 17, 1969, National purchased 48,300 shares of its common stock in market transactions and Madison purchased 74,682 shares of the stock; that during 1968 National acquired in non-market transactions on conversion of debentures and from its subsidiaries 34,720 shares of its common stock; and that in market transactions during 1968 Madison purchased 95,900 shares of National com-

mon stock. Further answering, Corporate Defendants aver that the market purchases by National of its common stock during the year 1969 are fully and accurately disclosed in Exhibit A to this Joint Answer and as hereinbefore averred, the purchases by National of its common stock were wholly unrelated to the purchases made by Madison during the years 1968, 1969, and at any other time. Further answering, [58] Corporate Defendants admit that the primary disclosure with respect to National's purchases and transactions in its own securities appears at page 63 of the Proxy Statement and aver that its purchases of its common stock during the period June 30 through September 30, 1969 are accurately disclosed at page 69 thereof. Corporate Defendants aver that the employment contract and the transactions between National and Charles F. Simonelli are fully and accurately disclosed at pages 44 and 45 of the Proxy Statement. Corporate Defendants admit that National did not dispose of any of its shares of its common stock purchased by it during 1968 or 1969 in market transactions during those years. Corporate Defendants admit the allegations of the final sentence of sub-subparagraph (5).

(o) Corporate Defendants deny the allegations of subparagraph (o). Further answering the numbered sub-subparagraphs of subparagraph (o), Corporate Defendants:

(1) Aver that National's cash flow projections in October 1969 indicated that it would be able to service its debt requirements over the ensuing five year period out of projected earnings and operations of National a. d its consolidated subsidiaries; and

[59] (2) Aver that full, accurate and complete disclosure with respect to TSC's loan agreement with The First National Bank of Chicago is made in the Proxy Statement at pages 8, 12-13, 72-76 and in particular in a detailed Note 5—Long Term Debt at page 76.

(p) Corporate Defendants deny the allegations of subparagraph (p), except that they admit the allegations of the first two sentences thereof. Further answering, Corporate Defendants aver that the factors in the decline in earnings of TSC and its consolidated subsidiaries during the nine month period ended July 31, 1969, are not only identified at pages 19 and 20 of the Proxy Statement but also at page 38 of the Proxy Statement where the relative contributions of the Tractor Division and Community Division of TSC to the results for fiscal year 1968 and for the first nine months ended July 31, 1968 and 1969 are shown by reference to percentages of net sales of each division and the percentages of net income produced by each division for the comparable periods, and the 8% contribution to net income before taxes of the Community Division in the nine month period ended July 31, 1969; further, this explanation [60] is cross-referenced in a footnote at page 38 of the Proxy Statement. With respect to the third sentence and the six enumerated sub-subparagraphs which comprise the bulk of it, Corporate Defendants:

(1) Aver that the reported reduction in income before taxes for the nine month period ended July 31, 1969, was approximately $2,352,000 and that the three factors referred to were correctly identified at page 20 of the Proxy Statement as being "the most significant factors that contributed to Community's adverse earnings report." Corporate Defendants admit that the $2,352,000 reduction in pre-tax income of TSC and consolidated subsidiaries for the nine month period ended July 31, 1969, included a charge of $62,500 in future compensation payments under an employment contract with Carl Sharfman, who had at that time been relieved of active duties making the charge appropriate since his employment contract then had no further value to TSC. Months later when the Kansas City manager left TSC, Carl Sharfman took his place in October, 1969. Corporate Defendants aver that this charge

had no material impact on the earnings figures of TSC and consolidated subsidiaries [61] as reported in the Proxy Statement.

(2) Admit that a dollar value was not attributed to each of the three factors and aver that such markdowns were taken consistently with good accounting and merchandising practice in the operation of a chain retail business and that it was neither necessary nor desirable to specifically identify the particuar items which entered into inventory valuation and such items are not normally delineated in financial reports. Corporate Defendants further aver that when an inventory count and valuation was completed at the fiscal year end on October 31, 1969, it was determined that further markdowns should have been taken at July 31, 1969.

(3) Admit that the inventory values set forth at July 31, 1969, reflected $366,000 of estimated inventory shrinkage attributable to the five Kansas City Stores in the nine month period ended July 31, 1969, which was in excess of the anticipated percentage used to estimate inventory shrinkage for the Community Division taken without inventory count or valuation since the fiscal year began on the previous November 1; that facts alerting management to the status of the inventory first came to the attention [62] of management of TSC in late March or early April, 1969, and that there was then no way to eliminate the possibility that a portion of inventory shrinkage had occurred during the preceding fiscal year. Corporate Defendants aver that inventory shrinkage at a relatively high level is commonplace in discount-type retail operations which are not operating profitably in other respects and, further answering, aver that the inventory shrinkage and other judgments made in inventory valuation were done in accordance with generally accepted accounting principles consistently applied with respect to TSC's operations, and

in particular with respect to the operations of the Community Discount Division. Corporate Defendants further aver that when an inventory count and valuation was completed at the end of the October 31, 1969 fiscal year, it was determined that further inventory shrinkage should have been taken at July 31, 1969.

(4) Aver that management of TSC had not made a decision to dispose of or otherwise close the five Kansas City Stores which were opened under Community's management in May 1968, and that the losses attributable to the operation of such stores were properly taken into account as losses incurred in the conduct of the normal and continuing [63] operations of TSC's Community Division.

(5) Admit that the precise amount attributable to "anticipated losses on disposition of certain fixed assets" as that term is used at the foot of page 20 of the Proxy Statement was not spelled out as being approximately $144,000, but Corporate Defendants aver that the failure to identify this particular amount was not significant or in any way material in relation to the $2,352,000 reduction in TSC's pre-tax earnings or in the presentation of the Consolidated Statement of Income of TSC Industries, Inc. and its consolidated subsidiaries at pages 19 and 20 of the Proxy Statement. Corporate Defendants aver that both the $31,000 loss attributable to nonproductive real estate condemned by public authorities in the City of Chicago and the $113,000 loss on furniture and improvements in a Community Discount Division Store to be closed were properly reflected in the financial statements of TSC for said nine month period in accordance with prior practice and with generally accepted accounting principles.

(6) Corporate Defendants adopt their answer to subsubparagraph (1) of this subparagraph.

[64] (q) Corporate Defendants deny the allegations of subparagraph (q) and, further answering, aver that the identified

references to the joint letter to shareholders and to page 6 of the Proxy Statement adequately and fairly informed the stockholders of National and TSC in respect of the matters alleged in subparagraphs (1), (2) and (3) of subparagraph (q).

(r) Corporate Defendants deny the allegations of subparagraph (r) and, further answering, aver:

(1) That the holders of TSC preferred stock received National Series B preferred stock and National warrants worth not less than $14.00 in exchange for each share of TSC preferred stock which had a fair value of not more than $12.00; whereas the holders of TSC common stock received new National securities worth not less than $14.30 in exchange for each share of TSC common stock, which was worth not more than $13.25 in early November, 1969. Corporate Defendants aver that the holders of TSC preferred stock, as a result of the transaction, increased their annual dividend per share from 70¢ to 75¢ while the holders of TSC common stock, as a result of the transaction, increased their dividend return from 60¢ to 62½¢, and each of them [65] had the opportunity to either hold or sell the National warrants received by them as they saw fit.

(2) That the information shown on page 23 of the Proxy Statement is fairly and accurately shown in its context as one portion of an 80 page Proxy Statement.

(3) That the Pro Forma Combined Income Summary which appears at page 21 of the Proxy Statement was not in any way false or misleading.

(4) That the fair value of the National securities received by the stockholders of TSC was greater than the fair value of the stock held by such TSC shareholders prior to consummation of the transaction.

15. By causing the false and misleading joint proxy statement to be unlawfully mailed to the stockholders of TSC

through the United States Mails, National, through its control of TSC and its management, caused sufficient proxies to be received from the independent TSC stockholders and voted in favor of said transaction and plan to sell the assets of TSC to National and liquidate and dissolve TSC, so that together with the votes of TSC shares owned by National, said transaction and plan was ostensibly approved. Without the use of proxies procured from the independent stockholders of TSC through the use of the unlawfully mailed joint proxy statement, said transaction and plan could not have been approved.

Answer:

Corporate Defendants deny the allegations of Paragraph 15, except that they admit that the Proxy Statement [66] was mailed to the stockholders of TSC and to the sockholders of National through the United States mails, and that it was necessary that a substantial number of TSC stockholders, in addition to National, vote in favor of the transaction and plan for the transaction and plan to be approved by the shareholders of TSC under the Certificate of Incorporation of TSC in effect at the time the Proxy Statement was mailed.

16. Pursuant to the ostensible but unlawful approval of said transaction and plan described in said joint proxy statement, National, through its control over TSC, has unlawfully proceeded to carry out said plan, and has caused the assets of TSC to be transferred to its wholly owned subsidiary, NII, Inc., the name of TSC to be changed, TSC to be placed in liquidation and dissolution, notices to be sent to TSC's independent stockholders that they are required to exchange their shares for the securities of National in accordance with the plan, has caused the exchange of such shares, and has thereby acquired the assets and business of TSC for substantially less than the fair value thereof, and has otherwise caused TSC and its independent stockholders great financial and other injury.

Answer:

Corporate Defendants deny the allegations of Paragraph 16, except that they admit that, following approval of the plan, the transaction was carried out as described at page seven of the Proxy Statement and that the saareholders of TSC were notified to exchange their shares for the [67] securities of National, which were issued in accordance with the plan and National, upon consummation of the plan, acquired the assets and business of TSC.

17. All of the acts and deeds done or caused to be done by National in pursuance of its illegal and fraudulent plan were in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the General Rules and Regulations thereunder.

Answer:

Corporate Defendants deny the allegations of Paragraph 17.

18. Any and all acts and deeds done and proposed to be done by the defendants, or any of them, in consummation of said illegal and fraudulent plan are and will be void as regards the rights of the defendants in said transaction, pursuant to the provisions of Section 29(b) of the Securities Exchange Act of 1934.

Answer:

Corporate Defendants deny the allegations of Paragraph 18.

19. No demand to correct the wrongs to TSC complained of has been made upon the officers, directors or shareholders of TSC because it would have been futile to do so since said officers and directors, as well as National, the controlling stockholder of TSC, are each and all the wrongdoers and have advanced and supported said wrongs; demand would also be futile since in order to comply said wrongdoers would have to take action, legal or otherwise, against themselves and against their interests.

[68] *Answer:*

Corporate Defendants deny the allegations of Paragraph 19, except that they admit no demand was made. Further answering, Corporate Defendants aver that the directors and officers of TSC, as well as National, at all relevant times have acted in good faith and in the best interests of TSC and its stockholders; have fully and fairly discharged all legal and equitable obligations and duties to TSC and its stockholders; and that TSC has no basis for a claim against any of the other defendants upon which relief may be granted.

20. The class of stockholders or former stockholders of TSC similarly situated to plaintiff, includes thousands of persons, too numerous for joinder of all members to be practicable. There are questions of law and fact common to this class; the claims of the plaintiff are typical of the claims of the class; and the plaintiff, as the representative of the class, will fairly and adequately protect the interests of the class.

Answer:

Corporate Defendants deny the allegations of Paragraph 20, and, further answering, aver that this Court has heretofore ruled that Plaintiff may not proceed in this action on the theory that it is a class action under Rule 23 of Federal Rules of Civil Procedure.

[69] 21. This action is not a collusive one brought for the purpose of conferring jurisdiction upon this Court.

Answer:

Corporate Defendants admit the allegations of Paragraph 21.

[70] WHEREFORE, plaintiff prays that this Court grant such of the following relief as it deems just:

A. Enter judgment in favor of TSC against National and NII, Inc. for the sum of $63 million, interest, litigation expenses including attorneys' fees, and costs.

B. Enter judgment in favor of the independent stockholders of TSC against National, NII, Inc. and TSC for the sum of $42 million, interest, litigation expenses including attorneys' fees, and costs.

C. Order that National and NII, Inc. make restitution in cash, debt obligations, or other securities as the Court may determine, to TSC and its stockholders for any damages suffered by them or any of them, as a result of action taken by National either directly or through TSC or NII, Inc. to effectuate said plan, and further ordering such restitution to TSC and such stockholders for any unjust enrichment achieved by National or NII, Inc. as a result of said plan or of any action taken in connection therewith or pursuant thereto.

D. Order that National and NII, Inc. account to TSC and its stockholders for all profits, properties and proceeds received by National and NII, Inc., and for all losses sustained by TSC and its stockholders as a result of said plan or of any action taken in connection therewith or pursuant thereto.

E. Enter appropriate orders: (i) rescinding, setting aside and holding for naught the purported plan of sale of assets of TSC to National; (ii) setting aside and holding for naught any action heretofore or hereafter taken pursuant to or in carrying out said plan, including any purported transfer to NII, Inc.; (iii) enjoining any further action toward carrying out said plan; (iv) causing the corporate charter of TSC to be reinstated and preserved, its assets to be returned to it and the business of TSC to be continued with its franchise and business unimpaired; (v) causing the respective interests of the stockholders of TSC to be reinstated substantially as they existed immediately [71] prior to the issuance of said joint proxy statement, on such terms and conditions, or as of such other date as the Court deems appropriate; (vi) assuring that shares of TSC previously owned and held by the Schmidt defendants and any other remaining shares of TSC owned by National be hereafter held

and voted by such person or persons as may be designated by the Court to act as trustee thereof until such shares can be sold in a public offering under a plan of underwriting which will protect TSC and its stockholders from further depredations by the Schmidt defendants, National or anyone to whom they might sell their shares of TSC, including such additional steps as may be necessary to fully protect TSC and its stockholders from any abuse of fiduciary relationship by the Schmidt defendants, National or their successors; and (vii) providing for compensation or other protection for any persons acquiring shares or warrants of National issued pursuant to said plan.

F. Order that National and NII, Inc. be divested of all assets, stockholdings or other interest in TSC, and that all assets, business and properties of TSC, or shares of stock representing the complete ownership of TSC, be offered for sale or exchange under Court supervision to the public or to such persons or corporations, including the former independent stockholders of TSC, and on such terms as the Court may approve, and that the proceeds of such sale or other disposition be distributed to or otherwise made available for the benefit of TSC and its independent stockholders.

G. Grant such other and further relief as the Court shall deem just and appropriate.

[72] CORPORATE DEFENDANT'S REQUEST FOR RELIEF.

Defendants TSC Industries, Inc., National Industries, Inc. and TSC Industries, Inc. (formerly named NII, Inc.) request a judgment of non-liability in their favor against Plaintiff Northway, Inc. under Count I and that the costs of these Defendants be assessed against Plaintiff.

[73] *Count II*

As and for its second Count, plaintiff complains of defendants TSC, National and NII, Inc. and alleges as follows:

1. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 1 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 1 of Count I.

2. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 2 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 2 of Count I.

3. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 3 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 3 of Count I.

4. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 4 of Count I of this Complaint.

[74] *Answer*:

Corporate Defendants adopt their answer to Paragraph 4 of Count I.

5. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 5 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 5 of Count I.

6. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 6 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 6 of Count I.

7. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 7 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 7 of Count I.

8. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 8 of Count I of this Complaint.

[75] *Answer*:

Corporate Defendants adopt their answer to Paragraph 8 of Count I.

9. On or about October 24, 1969 National permitted its name to be used in, or caused TSC to issue to its independent stockholders through the United States mails, a joint proxy statement (issued by both National and TSC) dated November 12, 1969, soliciting proxies of the independent stockholders of TSC to be voted in favor of a proposed plan and agreement to sell TSC's assets to National and to liquidate and dissolve TSC as described in said joint proxy statement. A copy of said joint proxy statement (including the letter of transmittal constituting the cover page thereof and all exhibits thereto) is attached as Exhibit A to the copy of this Amended, Restated and Supplemental Complaint which has been filed with the Court, and is made a part hereof.

Answer:

Corporate Defendants deny the allegations of Paragraph 9, except they admit that a copy of the Proxy Statement is attached as Exhibit A to the Complaint. Further answering, Corporate Defendants aver that by letter dated October 20, 1969, legal counsel for TSC transmitted preliminary copies of proxy soliciting material to the Securities and Exchange Commission pursuant to Rule 14(a)(6) of Regulation 14A of the Securities Exchange Act of 1934, which materials were received by the Commission on October 21, 1969. On November 1, 1969, The First National Bank of Chicago erroneously [76] mailed the proxy card, return envelope and exhibits to the proxy statement to the stockholders of TSC for use in connection with the Special Meeting of Stockholders of TSC then scheduled for December 1, 1969. By letter dated November 4, 1969, The First National Bank of Chicago, in accordance with the suggestions of the New York Stock Exchange, with the concurrence of the Securities and Exchange Commission and at the request of TSC's legal counsel, advised the stockholders of TSC of the Bank's error, asked the stockholders to disregard the mailing and destroy the materials previously received, and advised the stockholders that definitive and distinguishing proxy material would be prepared and forwarded to the stockholders when the comments from Securities and Exchange Commission had been received. By letter dated November 10, 1969, to legal counsel for TSC, the Securities and Exchange Commission made its comments on the preliminary copies of proxy soliciting material. By letter dated November 12, 1969, legal counsel for TSC transmitted definitive copies of the proxy material to the Securities and Exchange Commission and, on the same date, National and TSC transmitted copies of their respective proxy materials to their respective stockholders.

[77] 10. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 14 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 14 of Count I.

11. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 15 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 15 of Count I.

12. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 16 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 16 of Count I.

13. The mailing of said joint proxy statement, as aforesaid, was in violation of Section 14(a) of the Securities Exchange Act of 1934 and Regulation 14A of the General Rules and Regulations thereunder.

Answer:

Corporate Defendants deny the allegations of Paragraph 13.

[78] '4. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 18 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 18 of Count I.

15. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 19 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 19 of Count I.

16. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 20 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 20 of Count I.

17. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 21 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 21 of Count I.

[79] WHEREFORE, plaintiff prays that this Court grant such of the following relief as it deems just:

A. Enter judgment in favor of TSC against National and NII, Inc., for the sum of $63 million, interest, litigation expenses including attorneys' fees, and costs.

B. Enter judgment in favor of the independent stockholders of TSC against National NII, Inc. and TSC for the sum of $42 million, interest, litigation expenses including attorneys' fees, and costs.

C. Order that National and NII, Inc. make restitution in cash, debt obligations, or other securities as the Court may determine, to TSC and its stockholders for any damages suffered by them, or any of them, as a result of action taken by National either directly or through TSC or NII, Inc. to effectuate said plan, and further ordering such restitution to TSC and such stockholders for any unjust enrichment achieved by National or NII, Inc. as a result of said plan or of any action taken in connection therewith or pursuant thereto.

D. Order that National and NII, Inc. account to TSC and its stockholders for all profits, properties and proceeds received by National and NII, Inc., and for all losses sustained by TSC and its stockholders as a result of said plan or of any action taken in connection therewith or pursuant thereto.

E. Enter appropriate orders: (i) rescinding, setting aside and holding for naught the purported plan of sale of assets of TSC to National; (ii) setting aside and holding for naught any action heretofore or hereafter taken pursuant to or in carrying out said plan, including any purported transfer to NII, Inc.; (iii) enjoining any further action toward carrying out said plan; (iv) causing the corporate charter of TSC to be reinstated and preserved, its assets to be returned to it and the business of TSC to be continued with its franchise and business unimpaired; (v) causing the respective interests of the stockholders of TSC to be reinstated substantially as they existed immediately prior to the issuance of said joint proxy statement, on such terms and conditions, or as of such other date as the Court deems [80] appropriate; (vi) assuring that shares of TSC previously owned and held by the Schmidt defendants and any other remaining shares of TSC owned by National be hereafter held and voted by such person or persons as may be designated by the Court to act as trustee thereof until such shares can be sold in a public offering under a plan of underwritting which will protect TSC and its stockholders from further depredations by the Schmidt defendants, National or anyone to whom they might sell their shares of TSC, including such additional steps as may be necessary to fully protect TSC and its stockholders from any abuse of fiduciary relationship by the Schmidt defendants, National or their successors; and (vii) providing for compensation or other protection for any persons acquiring shares or warrants of National issued pursuant to said plan.

F. Order that National and NII, Inc. be divested of all assets, stockholdings, or other interest in TSC, and that all

assets, business and properties of TSC, or shares of stock representing the complete ownership of TSC, be offered for sale or exchange under the Court supervision to the public or to such persons or corporations, including the former independent stockholders of TSC, and on such terms as the Court may approve, and that the proceeds of such sale or other disposition be distributed to or otherwise made available for the benefit of TSC and its independent stockholders.

G. Grant such other and further relief as the Court shall deem just and appropriate.

CORPORATE DEFENDANTS' REQUEST FOR RELIEF.

Defendants TSC Industries, Inc., National Industries, Inc. and TSC Industries, Inc. (formerly named NII, Inc.) request a judgment of non-liability in their favor against [81] Plaintiff Northway, Inc. under Count II and that the costs of these Defendants be assessed against Plaintiff.

[82] *Count III*

As and for its third Count, plaintiff complains of defendants Charles E. Schmidt, Dorothy F. Schmidt, Richard L. Schmidt, Charles E. Schmidt, Jr., Charles E. Schmidt and Dorothy F. Schmidt Family Foundation (together referred to as the "Schmidt defendants"), and of defendants National, NII, Inc., and TSC, and alleges as follows:

1. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 1 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 1 of Count I.

2. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 2 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 2 of Count I.

3. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 3 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 3 of Count I.

[83] 4. Plaintiff adopts and realleges ts though fully set forth herein each of the allegations contained in paragraph 4 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 4 of Count I.

5. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 5 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 5 of Count I.

6. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 6 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 6 of Count I.

7. On or about January 11, 1968, and for a period of years prior thereto, the Schmidt defendants owned approximately 58% of the outstanding stock of Community Discount Centers, Inc. ("Community") and approximately 18% of the outstanding stock of Tractor Supply Co. ("Tractor"), except that the Schmidt Foundation owned no stock of either of said companies and Charles E. Schmidt, Jr. owned no stock of Tractor. Immediately prior to said date and for a period of years prior thereto the outstanding capital stock of both [84] Tractor and the outstanding capital stock of Community was publicly held and traded, with the capital stock of Tractor being registered for trading on the New York Stock Exchange and that of Community being so registered on the American Stock Exchange. Immediately prior to said date and for a period of years prior thereto defendant Charles E. Schmidt, individually, and the Schmidt defendants (except the Schmidt Foundation, and as to Tractor, Charles E. Schmidt, Jr.) possessed, directly or indirectly, the power to direct or cause the direction of the management and policies of both Community and Tractor, and had actual or working control of each of said corporations. Charles E. Schmidt and Charles E. Schmidt, Jr. with certain executives of Community and Tractor formulated and implemented a proposal, submitted to the stockholders of both corporations by means of a joint proxy statement dated January 11, 1968, for the merger of said corporation to form TSC. Approval of the proposed merger required the affirmative votes of two-thirds of the stockholders of each corporation, and the affirmative votes of independent stockholders of both corporations were sought and obtained through said proxy solicitation in order to effectuate said merger. As part of the same proxy solicitation and as part of the plan of merger, there was included in said joint proxy statement of January 11, 1968 the designation of the persons who were to serve as the directors of TSC, the resulting corporation. The persons so designated to serve as directors included defendants Charles E. Schmidt and Charles E.

Schmidt, Jr., and they were elected directors along with the other persons so designated through the exercise of the proxies so solicited. Charles E. Schmidt and Charles E. Schmidt, Jr. continued as directors of TSC pursuant to this election until the sale of the shares of TSC owned by the Schmidt defendants to National as referred to in Paragraph 11 and 12 of this Count III.

Answer:

Corporate Defendants admit the allegations of Paragraph 7, except that they are without knowledge or information sufficient to form a belief as to the truth of [85] the allegation that the Schmidts possessed the power to direct the management and policies of Community and Tractor or had control of either of the corporations.

8. As a result of said merger creating TSC, effective February 19, 1968, defendant Charles E. Schmidt, individually, and the Schmidt defendants (including the Schmidt Foundation from and after it acquired shares of TSC), possessed, directly or indirectly, the power to direct or cause the direction of the management and policies of TSC, had actual or working control of TSC, and had control of TSC's proxy machinery, the power to designate the management slate of directors and all officers of TSC, and the power to dominate and determine its business affairs and operations. Defendant Charles E. Schmidt, individually, and the Schmidt defendants, continued to possess said power of direction and control of TSC until on or about the date of the transfer of all of their respective TSC shares to National and the delivery by each of them to National of irrevocable proxies with respect thereto pursuant to the agreement dated as of January 30, 1969 which is referred to in paragraph 12 of this Count III.

Answer:

Corporate Defendants adopt their answer to Paragraph 8 of Count I.

9. On or about January 16, 1969, Charles E. Schmidt and the other Schmidt defendants owned beneficially or of record the following shares of TSC Common Stock and TSC Preferred Stock, respectively:

	Name	TSC Common	TSC Preferred
	Charles E. Schmidt	418,545	338,974
	Dorothy F. Schmidt	5,297	30,000
	Richard L. Schmidt	6,000	30,001
[86]	Charles E. Schmidt, Jr.	1,000	40,700
	Charles E. Schmidt and Dorothy F. Schmidt Family Foundation	3,840	
		434,682	439,675

The aforesaid shares of the Schmidt defendants represented approximately one-third of the voting power of all outstanding shares of TSC.

Answer:

Corporate Defendants admit the allegations of Paragraph 9.

10. Shortly before January 16, 1969, Charles E. Schmidt determined to dispose and divest himself of certain of his TSC Common Stock and to conceal such action from other TSC stockholders in order to avoid dilution of his opportunities in the market and to deprive other TSC stockholders of participation in market opportunities. In the exercise of his control over TSC's management and policies, Schmidt caused TSC to prepare and submit to the SEC on January 16, 1969, a registration statement including a preliminary prospectus for a public offering at 355,000 shares of TSC Common Stock. The shares of TSC Common Stock to be offered pursuant to this registration statement included 200,000 shares of which 194,703 were owned by Charles E. Schmidt, and 5,297 were owned by his wife, defendant Dorothy F. Schmidt. In the exercise of control over the proxy machinery, and on or about the same day, January 16, 1969, Charles E.

Schmidt caused or permitted TSC to mail a proxy statement soliciting proxies from TSC Stockholders for the election of Charles E. Schmidt and others as directors of TSC, without disclosing the planned disposition by Charles E. Schmidt and his wife of said TSC Common Stock as aforesaid; or the filing or planned filing of said registration statement.

Answer:

Corporate Defendants deny the allegations of [87] Paragraph 10, except they admit that at some time before January 16, 1969, Charles E. Schmidt determined to dispose and divest himself of certain of his TSC common stock by a public offering and that a registration statement was submitted to the SEC on January 16, 1969, which included 200,000 shares, of which 194,703 were owned by Charles E. Schmidt and 5,297 were owned by his wife, defendant Dorothy F. Schmidt.

11. On January 16, 1969, Charles E. Schmidt met with representatives of National, including Yarmuth, Simonelli, Solomon and Ivan Greenspan who was a National Vice President primarily involved in National's acquisition activities, and commenced negotiations for the sale to National of all shares of TSC owned by Charles E. Schmidt and the other Schmidt defendants. During these negotiations Charles E. Schmidt received information concerning National, including information with respect to National's financial condition, its diverse operations, its rapid growth by the acquisition of numerous businesses using various types of acquisition transactions, including the purchase of a substantial interest for cash and notes followed by the acquisition of the entire business by means of a merger or other transaction using National equity security, and National's intention to continue to seek to acquire other businesses and product lines. Among other such information received from National, Charles E. Schmidt received a copy of the National Prospectus dated October 3, 1968, which is attached as Exhibit C to the copy of this Amended, Restated and Supplemental Complaint filed with the Court, and is made a part hereof.

Answer:

Corporate Defendants deny the allegations of [88] Paragraph 11, except they admit that the named representatives of National met with Mr. Schmidt on January 16, 1969 and gave Mr. Schmidt a copy of National's Prospectus dated October 3, 1968. Further answering, Corporate Defendants deny that National's representatives gave Mr. Schmidt any significant information at the January 16, 1969 meeting beyond that contained in the Prospectus.

12. As a result of said negotiations, National and the Schmidt defendants entered into an agreement dated as of January 30, 1969, a copy of which (including the supplement thereto dated February 6, 1969) is attached hereto as Exhibit B. Pursuant to that agreement:

(a) National acquired from defendant Charles E. Schmidt and the other Schmidt defendants a total of 434,682 shares of TSC Common Stock for cash and National's notes totalling $13,040,460 ($30 per share) and 439,675 shares of TSC Preferred Stock for cash and National's notes totalling $9,892,-687.50 ($22.50 per share). The total of $22,933,147.50 was payable one-fourth in cash and the balance in National's 5% notes payable in six annual installments. As additional consideration under the agreement, National transferred to said Schmidt defendants warrants to purchase a total of 125,000 shares of National Common Stock during the year commencing February 7, 1974 at $24 per share.

(b) In addition to said TSC shares, National received from each of the Schmidt defendants irrevocable proxies with respect to said shares, at the closing under said agreement at Chicago, Illinois, on February 7, 1969. Defendant Charles E. Schmidt tendered his resignation as a director of TSC at the execution of said agreement on [89] January 30, 1969, and his son, defendant Charles E. Schmidt, Jr., tendered his resignation as a director of TSC on February 7, 1969. Up to the time of said

transaction and at all material times prior thereto, defendant Charles E. Schmidt, individually, and the Schmidt defendants, possessed, directly or indirectly, the power to direct or cause the direction of the management and policies of TSC, had actual or working control of TSC, and had control of TSC's proxy machinery, the power to designate the management slate of directors and all officers of TSC, and the power to dominate and determine its business affairs and operations. By virtue of said transaction, defendant Charles E. Schmidt and the Schmidt defendants transferred to National, and National acquired, the power to direct or cause the direction of the management and policies of TSC, actual or working control of TSC, and control of TSC's proxy machinery, the power to designate the management slate of directors and all officers of TSC, and the power to dominate and determine its business affairs and operations.

Answer:

Corporate Defendants deny the allegations of Paragraph 12, except they admit the allegations of subparagraph (a) and so much of subparagraph (b) as pertains to the resignations of the Schmidts and National's receipt of irrevocable proxies.

13. At the time of said transaction, National was in search of additional acquisitions in furtherance of its then existing program of acquiring complete ownership of businesses wherever feasible. National's acquisition of said shares of TSC from the Schmidt defendants was made pursuant to and in furtherance of this program and with the intention of acquiring complete ownership of the business of TSC. At the time of said transaction, there was no reasonable prospect that National would be able to pay for the re- [90] maining outstanding Common and Preferred shares of TSC or its assets and business on the same price and terms, and in the same forms of consideration as accorded the Schmidt defendants.

Answer:

Corporate Defendants deny the allegations of Paragraph 13, except they admit that National was in search of additional acquisitions.

14. Prior to and at the time said agreement was entered into with National, Charles E. Schmidt, individually, and the Schmidt defendants, knew, or in the exercise of reasonable diligence should have known or foreseen, among other things, that:

(a) National was a conglomerate engaged in various diverse businesses through controlled subsidiary operating companies;

(b) National since at least 1963 had expanded its operations through acquisitions and the development of acquired businesses, using various types of acquisition transactions, including the purchase of a substantial interest for cash or notes followed by a merger or other similar acquisition transaction using National stock or other equity securities, to acquire the entire business;

(c) On July 1, 1968 National had acquired 100% ownership of Retail Centers of the Americas, Inc., Cott Corporation and Crescent Corporation through mergers into National using National equity securities, including National's Series B Preferred Stock with respect to the Crescent merger, after National had first acquired for cash a 66% stock interest in Retail Centers, a 55% interest in Cott, and a 37% Common Stock interest in Crescent. In the proxy statement of May 17, 1968 which National issued in connection with each of these mergers, National declared [91] that each of these mergers was believed by National's Board of Directors to be consistent with National's program of acquiring complete ownership of businesses wherever feasible.

(d) In November of 1968 National acquired 100% ownership of Hawthorn-Mellody, Inc. and Royal School Laboratories, Inc. through the merger of these corporations into National using

National equity securities, after National had first acquired in July of that year a 52% stock interest in Hawthorn-Mellody for cash and a 59% stock interest in Royal as a result of the Crescent merger. In the proxy statement of September 27, 1968 which National issued with respect to each of these mergers, National declared that its Board of Directors believed each of these mergers to be consistent with National's program of acquiring complete ownership of businesses wherever feasible.

(e) In the National Prospectus of October 3, 1968 which was delivered to Charles E. Schmidt (Exhibit C), National referred to the then pending Hawthorn-Mellody and Royal mergers, among other things, and declared that National intended to continue to seek to acquire other businesses and product lines, for cash or securities, or both, of kinds and types deemed advantageous by management.

(f) By virtue of said transaction and pursuant to said agreement dated as of January 30, 1969, Charles E. Schmidt, individually, and the Schmidt defendants, were transferring to National, and National was acquiring, the power to direct or cause the direction of the management and policies of TSC, actual or working control of TSC, and control of TSC's proxy machinery, the power to designate the management slate of directors and all officers of TSC, and the power to dominate its business affairs and operations.

(g) At the time of said transaction, National was in search of additional acquisitions in furtherance of its then existing program of acquiring complete ownership of businesses wherever feasible.

(h) National's acquisition of said shares of TSC [92] from the Schmidt defendants was made pursuant to and in furtherance of this program and with the intention of acquiring complete ownership of the business of TSC.

(i) At the time of said transaction, there was no reasonable prospect that National would be able to pay for the remaining

outstanding Common and Preferred shares of TSC or its assets or business on the same price and terms and in the same forms of consideration as accorded the Schmidt defendants. Instead, National would acquire 100% ownership of TSC using National equity securities which were junior to and stood behind National's indebtedness to the Schmidt defendants, as well as behind other substantial indebtedness of National and would use its control of TSC to effect such acquisition in its own interests and to use the earnings and cash flow of TSC for the payment of National's indebtedness, including its indebtedness to the Schmidt defendants.

Answer:

Corporate Defendants deny the allegations of subparagraphs (f), (g), (h) and (i) of Paragraph 14 and aver they are without knowledge or information sufficient to form a belief as to the truth of the remaining allegations thereof.

15. In negotiating, entering into and consummating said agreement of January 30, 1969, Charles E. Schmidt, individually, and the Schmidt defendants were guilty of the following wrongful acts, among others:

(a) Said defendants failed to have included in said agreement, and failed to make any effort or attempt to have included therein, any terms or provisions to insure that National would not acquire or attempt to acquire complete ownership of TSC, except at a price and on terms at least equal to and not less favorable than those accorded by National to the Schmidt defendants.

[93] (b) Said defendants failed to have included in said agreement, and failed to make any effort or attempt to have included therein, any terms or provisions to insure that National would not utilize its control of TSC to its own exclusive advantage and to the detriment of TSC and its independent stockholders.

(c) Said defendants transferred actual or working control of TSC to National, and aided and abetted National in acquiring

complete ownership of TSC for newly issued equity securities at a fraudulently low and grossly inadequate consideration and at a price and on terms which were substantially less favorable to TSC and the independent stockholders of TSC than those accorded the Schmidt defendants, and which were otherwise grossly unfair to TSC and the independent stockholders of TSC.

(d) Said defendants transferred their shares of TSC to National in a manner which resulted in their receiving a substantially higher price for their shares than was received by the independent stockholders of TSC, which higher price was payable in cash and notes of National which were senior to the substantially less valuable equity securities of National received by the independent stockholders of TSC and which would be payable to said Schmidt defendants wholly or partly out of the earnings and cash flow of TSC.

(e) Said defendants in disposing of and transferring, actual or working control of TSC to National, wrongfully used and employed said actual or working control to their own exclusive benefit and to the detriment and injury to TSC and its independent stockholders, and failed to exercise due and proper care and diligence to protect the interests of TSC and its independent stockholders.

Answer:

Corporate Defendants deny the allegations of Paragraph 15.

[94] 16. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 10 of Count I of this Complaint.

Answer:

Corporate Defendants adopted their answer to Paragraph 10 of Count I.

17. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 11 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 11 of Count I.

18. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 12 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 12 of Count I.

19. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 13 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 13 of Count I.

[95] 20. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 14 of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 14 of Count I.

21. Plaintiff adopts and realleges as though fully set forth herein each of the allegations contained in paragraph 15 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 15 of Count I.

22. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 16 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 16 of Count I.

23. By the aforesaid acts, Charles E. Schmidt, individually, and the Schmidt defendants engaged in acts, practices, and a course of business which operated as a fraud and deceit upon, and employed a manipulative device and a scheme and artifice to defraud, TSC and its independent stockholders in violation of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 of the General Rules and Regulations thereunder.

[96] *Answer*:

Corporate Defendants deny the allegations of Paragraph 23.

24. By the aforesaid acts, Charles E. Schmidt, individually, and the Schmidt defendants facilitated, aided and abetted, and participated in the commission of acts and practices by National in violation of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 of the General Rules and Regulations thereunder, and in violation of Section 14(a) of said 1934 Act and Regulation 14A of said General Rules and Regulations.

Answer:

Corporate Defendants deny the allegations of Paragraph 24.

25. By the aforesaid acts, National knowingly facilitated, aided and abetted, and participated in the commission by Charles E. Schmidt, individually, and by the Schmidt defendants, of acts, practices, and a course of business which operated as a fraud and deceit upon, and the use of a manipulative device and a scheme and artifice to defraud, TSC and its independent stockholders in violation of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 of the General Rules and Regulations thereunder.

Answer:

Corporate Defendants deny the allegations of Paragraph 25.

26. Any and all acts and deeds done and proposed to be done by all or any of the defendants in consummation of [97] said illegal and fraudulent transactions were, are and will be void as regards the rights of the defendants in said transactions, pursuant to the provisions of Section 29(b) of the Securities Exchange Act of 1934.

Answer:

Corporate Defendants deny the allegations of Paragraph 26.

27. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 19 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 19 of Count I.

28. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 20 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 20 of Count I.

29. Plaintiff adopts and realleges as though fully set forth herein, each of the allegations contained in paragraph 21 of Count I of this Complaint.

Answer:

Corporate Defendants adopt their answer to Paragraph 21 of Count I.

[98] WHEREFORE, plaintiff prays that this Court grant such of the following relief as it deems just:

A. Enter judgment in favor of TSC against National, NII, Inc., and the Schmidt defendants, for the sum of $63,000,000, interest, litigation expenses including attorneys' fees, and costs.

B. Enter judgment in favor of the independent stockholders of TSC against National, NII, Inc., TSC, and the Schmidt defendants, for the sum of $42,000,000, interest, litigation expenses including attorneys fees, and costs.

C. Enter appropriate orders: (i) setting aside and holding for naught any and all notes or warrants of National heretofore issued by National to the Schmidt defendants on account of or as consideration for the purchase by National from the Schmidt defendants of shares of TSC; (ii) requiring each of the Schmidt defendants to forthwith repay to National any cash heretofore received by them on account of or as consideration for the purchase of shares of TSC by National from them, and to forthwith redeliver to National any notes and warrants so received by them; (iii) providing for redistribution on a pro rata basis of all cash, notes, warrants and preferred stock heretofore issued, paid or distributed by National to the Schmidt defendants for the purchase of their shares of TSC and to the independent stockholders of TSC pursuant to said plan of sale and liquidation, all on such conditions and with such adjustments as the Court deems just and appropriate; and (iv) providing for compensation or other protection for any persons acquiring shares or warrants of National issued pursuant to said plan of sale and liquidation.

D. Order that National, NII, Inc., and the Schmidt defendants make restitution in cash, debt obligations, or other securities as the Court may determine, to TSC and its stockholders for any damages suffered by them, or any of them; as a result of action taken by National either directly or through TSC or NII, Inc. to effectuate said plan, and further ordering such restitution to TSC and such stockholders for any unjust enrichment achieved by National, NII, [99] Inc., or the Schmidt defendants as a result of said plan or of any action taken in connection therewith or pursuant thereto.

E. Order that National, NII, Inc. and the Schmidt defendants, account to TSC and its stockholders for all profits, prop-

erties and proceeds received by National, NII, Inc., and the Schmidt defendants, and for all losses sustained by TSC and its stockholders as a result of said plan or of any action taken in connection therewith or pursuant thereto.

F. Enter appropriate orders: (i) rescinding, setting aside and holding for naught the purported plan of sale of assets of TSC to National; (ii) setting aside and holding for naught any action heretofore or hereafter taken pursuant to or in carrying out said plan, including any purported transfer to NII, Inc.; (iii) enjoining any further action toward carrying out said plan; (iv) causing the corporate charter of TSC to be reinstated and preserved, its assets to be returned to it and the business of TSC to be continued with its franchise and business unimpaired; (v) causing the respective interests of the stockholders of TSC to be reinstated substantially as they existed immediately prior to the issuance of said joint proxy statement, on such terms and conditions, or as of such other date as the Court deems appropriate; (vi) assuring that shares of TSC previously owned and held by the Schmidt defendants and any other remaining shares of TSC owned by National be hereafter held and voted by such person or persons as may be designated by the Court to act as trustee thereof until such shares can be sold in a public offering under a plan of underwriting which will protect TSC and its stockholders from further depredations by the Schmidt defendants, National or anyone to whom they might sell their shares of TSC, including such additional steps as may be necessary to fully protect TSC and its stockholders from any abuse of fiduciary relationship by the Schmidt defendants, National or their successors; and (vii) providing for compensation or other protection for any persons acquiring shares or warrants of National issued pursuant to said plan.

[100] G. Order that National and NII, Inc. be divested of all assets, stockholdings, or other interest in TSC, and that all assets, business and properties of TSC, or shares of stock representing the complete ownership of TSC, be offered for sale or exchange under court supervision to the public or to such

persons or corporations, including the former independent stockholders of TSC, and on such terms as the Court may approve, and that the proceeds of such sale or other disposition be distributed to or otherwise made available for the benefit of TSC and its independent stockholders.

H. Grant such other and further relief as the Court shall deem just and appropriate.

[101] CORPORATE DEFENDANTS' REQUEST FOR RELIEF.

Defendants TSC Industries, Inc., National Industries, Inc. and TSC Industries, Inc. (formerly named NII, Inc.) request a judgment of non-liability in their favor against Plaintiff Northway, Inc. under Count III and that the costs of these Defendants be assessed against Plaintiff.

JOSEPH N. MORENCY, JR.,
JAMES T. OTIS,
WESLEY S. WALTON,
JOHN R. F. BAER,
134 South LaSalle Street,
Chicago, Illinois 60603,
726-9000,
Attorneys for Defendants TSC Industries, Inc., National Industries, Inc. and TSC Industries, Inc. (formerly named NII, Inc.)

Of Counsel:
PRICE, CUSHMAN, KECK &
MAHIN.

[102] CERTIFICATE OF SERVICE.

[Omitted in Printing.]

[103] SERVICE LIST.

[Omitted in Printing.]

JOINT ANSWER EXHIBIT "A"

NATIONAL INDUSTRIES, INC., MARKET PURCHASES OF ITS COMMON STOCK—3/24/69-12/31/69, INCLUSIVE

(1) Transaction Date	(2) Shares Bought	(3) Price Per Share	(4) Daily Trading Volume	(5) Monthly Trading Volume
3-25-69	1,000	16		
3-25-69	200	16		
3-25-69	2,000	16⅛	12,400	
3-26-69	1,000	16¼	11,500	49,200*
5-15-69	2,000	15	19,100	206,800
6-17-69	1,000	12	7,300	
6-20-69	2,800	12	4,700	
6-23-69	5,700	12	13,400	
6-24-69	1,500	12	5,900	
6-25-69	1,000	12	5,100	
6-26-69	1,000	12	10,400	153,000
7-11-69	4,300	11	7,600	
7-15-69	800	10	5,500	
7-23-69	400	10	7,400	
7-28-69	7,500	10	9,400	
7-29-69	4,200	10	8,600	
7-30-69	7,100	10	15,100	149,200
8-11-69	2,800	10	6,000	120,900
9-17-69	2,000	10	8,900	140,400
12-18-69	2,100	7¾	9,400	
12-23-69	2,900	7¾	10,500	272,700
Total Bought By National	53,300		Total Traded	1,685,800

* For period 3/24/69-3/28/69, only.

Sources: Columns 1-3, inclusive, National Industries, Inc. records.
Columns 4-5, *Wall Street Journal* reports.

IN THE UNITED STATES DISTRICT COURT
For the Northern District of Illinois
Eastern Division

[Title omitted in printing.]

PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT AS TO LIABILITY OF CORPORATE DEFENDANTS

Plaintiff, by its counsel, moves the Court pursuant to Rule 56(c), F. R. Civ. P., to enter partial summary judgment as to liability upon the claims set forth in Count I and Count II of the Amended, Restated and Supplemental Complaint against Defendants National Industries, Inc., TSC Industries, Inc. (presently called TS Liquidating Company), and TSC Industries, Inc. (formerly named NII, Inc., and being the successor to the business, assets and corporate name of said TSC Industries, Inc.) in favor of Plaintiff and all similarly situated stockholders or former stockholders of, and derivatively on behalf of, Defendant TSC Industries, Inc. (presently called TS Liquidating Company).

[2] The grounds of this Motion are that the pleadings, depositions, answers to interrogatories admissions, and exhibits on file show that there is no genuine issue as to any material fact concerning liability and that Plaintiff is entitled to said judgment as a matter of law, reserving issues of the relief to be granted for further hearing.

Said pleadings and other documents on file established that the Corporate Defendants did as a matter of law violate Sections 10(b) and 14(a) of the Securities Exchange Act of 1934, and Rule 10b-5 and Regulation 14A of the General Rules and Regulations thereunder, in connection with the acquisition of TSC Industries, Inc., its stock and assets, by

National Industries, Inc. and affiliated defendants. These Defendants violated said Act and Rules by employing a manipulative and deceptive scheme, device, and course of business which operated as a fraud and deceit upon TSC Industries, Inc., and to stockholders, and by mailing their Joint Proxy Statement dated November 12, 1969, which contained false and misleading statements of material facts and omitted to state material acts necessary to make the statements therein not false or misleading.

[3] These grounds are more fully set forth in the Memorandum in Support of Plaintiff's Motion for Summary Judgment as to Liability of Corporate Defendants, filed in support hereof.

Respectfully submitted,

/s/ STANLEY B. BLOCK,
One of the attorneys for Plaintiff Northway, Inc.

Dated: July 28, 1972

ARNOLD I. SHURE
11 South LaSalle Street
Chicago, Illinois 60603

STANLEY B. BLOCK
CHARLES R. KAUFMAN
39 South LaSalle Street
Chicago, Illinois 60603

ALEX ELSON
WILLARD J. LASSERS
11 South LaSalle Street
Chicago, Illinois 60603

HARRY B. REESE
357 East Chicago Avenue
Chicago, Illinois 60611

[A1] UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division
[Title omitted in printing.]

Corporate Defendants' Affidavits in Opposition to Plaintiff's Motion for Summary Judgment, Filed December 13, 1972.

• • • • •

OPPOSING AFFIDAVIT OF BERNARD H. BARNETT

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, Bernard H. Barnett on oath states:

1. I make this Opposing Affidavit in opposition to Plaintiff's Motion for Partial Summary Judgment As To Liability of Corporate Defendants, on my personal knowledge, and I could testify to the matters stated herein if called upon to do so.

2. I am an attorney, licensed to practice law in the State of Kentucky, with offices in Louisville, Kentucky. I am and have been at all times relevant to this action Chairman of the Board of Directors of Defendant National Industries, Inc., and a Director of Madison Fund, Inc. I know Mr. Stanley R. Yarmuth, [A2] President of Defendant National Industries, Inc., and I know Mr. Edward A. Merkle, President of Madison Fund, Inc.

3. During 1968 and 1969 while I was a director of Madison Fund, Inc., the management of the Fund purchased debentures and common stock of National Industries, Inc. from time to time in accordance with the general practice of the Fund's management to make and carry out investment decisions and later report them to the Board of Directors. I received reports of changes in the portfolio of the Fund, including the purchases of securities of National Industries, Inc., and such portfolio changes were then ratified by the Board of

Directors of the Fund. Such ratifications were made unanimously with respect to the Fund's purchases of debentures and common stock of National Industries, Inc. At no time did I participate in any decision of the Fund to make any of such investments in securities of National Industries, Inc. in advance of their being made. At no time did I have any advance knowledge of any market transaction by the Fund in the common stock of National Industries, Inc. It was the policy of the Fund not to inform its directors of security transactions prior to the release of reports on its investment portfolio. My only knowledge of any transactions by the Fund [A3] in the debentures or common stock of National Industries, Inc. was after the fact and was derived from my observation of reports on the Fund's investment portfolio.

4. During 1968 and 1969, I had no knowledge of any past, present or future plan, program, schedule or formula of Madison Fund, Inc. for the purchase or sale of common stock of National Industries, Inc.

5. At no time during 1968 and 1969 did I have any advance knowledge of any market transaction by National Industries, Inc. in its common stock. My sole knowledge of purchases by National Industries, Inc. of its common stock in market transactions was obtained after such purchases had been made.

6. I had no knowledge of any plan, program, schedule or formula of Defendant National Industries, Inc. for the purchase of its common stock during 1968 and 1969.

7. Plaintiff's counsel have not taken my deposition in this action.

/s/ BERNARD H. BARNETT
Bernard H. Barnett.

Sworn to and signed before me December 11th, 1972.

/s/ ALICE ROSSELL,
Notary Public State-at-Large, Kentucky.

[A4] UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

[Title omitted in printing.]

OPPOSING AFFIDAVIT OF CHARLES EVANS GERBER

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, Charles Evans Gerber on oath states:

1. I make this Opposing Affidavit in opposition to Plaintiff's Motion For Partial Summary Judgment As to Liability of Corporate Defendants, on my personal knowledge, and I could testify to the matters stated herein if called upon to do so.

2. I am an attorney, licensed to practice law in the State of Illinois, and I am a partner in the firm of Friedman, Koven, Shapiro, Salzman, Koenigsberg, Specks & Homer, 208 South [A5] LaSalle Street, Chicago, Illinois. At all times relevant to this action I have been associated with that law firm.

3. During the months of September, October and November, 1969, I, along with other members of our firm, was engaged in the preparation of the Proxy Statement which is Plaintiff's Exhibit 1 in this action.

4. Attached to this Affidavit is a copy of the Securities and Exchange Commission letter dated November 10, 1969, addressed to me and received by me on or immediately after that date and which relates to the preliminary proof of the Proxy Statement.

5. On March 10, 1970, at Chicago, Illinois, Plaintiff's counsel took my deposition upon oral examination. The transcript of that deposition, without exhibits, totals 156 numbered pages, but I was not fully examined about the subject matter of this Affidavit.

/s/ CHARLES EVANS GERBER,
Charles Evans Gerber.

Sworn to and signed before me December 1, 1972.

/s/ THERESA M. BAUER,
Notary Public.

[A6] GERBER EXHIBIT 1

Securities and Exchange Commission
Washington, D.C. 20549

November 10, 1969

Mr. Charles Evans Gerber
Friedman, Koven, Shapiro, Salzman,
Koenigsberg, Specks and Homer
208 S. LaSalle Street
Chicago, Illinois 60604

Re: National Industries
File No. 1-5512
TSC Industries
File No. 1-5554

Dear Mr. Gerber:

We have the following comments on the preliminary copies of proxy soliciting material (received October 21, 1969) for the special meeting of shareholders of the above companies.

Item (2) at the top of page 3 should be conformed to the proposal (2) of the TSC proxy card.

The price per share in each transaction should be set forth under "National Equity Interest in TSC.

The status of National Shares and Warrants to be issued for TSC stock owned by National should be specified under "Proposed Transactions".

We understand that additional disclosure will be made regarding the use of calcium cyclamate on page 26.

Financial Statements
Statements of Consolidated Income, Page 14

Net sales and operating revenues and cost of goods sold and operating expenses should be separately stated both here and

on Page 21, unless the lesser amount of each is less than 10% of the totals. Please revise or advise.

The caption "Cost of goods sold" should include a phrase such as "excluding depreciation, depletion and amortization shown below". Likewise Note K on Page 70 should indicate to what accounts these amounts are charged for purposes of determining overhead to be applied to inventories.

The annual interest requirement on the notes issued to purchase TSC stock should be shown in a note.

[A7] The income tax applicable to the income (loss) from extraordinary items should be shown for all transactions shown in Note (3). If no tax effect, it should be so stated.

A note to the statement and to the statement on Page 19 should state in tabular form for each period reported upon (1) the revenues and net income as originally reported to stockholders, (2) the amounts retroactively included in revenues and net income as a result of acquisitions accounted for as poolings if interest, and (3) the total of revenues and net income as now shown on page 14.

Consolidated Statement of Income, Pages 19-20

It is suggested that, if applicable, the caption operating expenses be charged to selling, general and administrative expenses. Otherwise please advise.

The preferred stock dividend requirements should be shown after "Net income" to arrive at net income applicable to common stock.

The amount of $696,595 shown in Note A and described as a duplication of net income does not agree with the amount of $241,243 shown in the statement of retained earnings on page 80. Appropriate change should be made or an explanation furnished.

Pro Forma Combined Income Summary, Page 21

It is suggested that the heading be labelled "Unaudited". This comment also applies to the pro balance sheet on page 52.

Information as to the proposed accounting for the disposition of the unallocated cost of assets in the amount of $20,945,000 should be given by supplemental letter.

The letter should include the effect on income. It is assumed that any tax savings will be applied to the excess.

The aggregate liquidation values of the Series A and B preferred stock should be given in a note referenced from the stockholders' equity.

Accounts payable and accrued expenses should be separately shown in accordance with the requirements of Rule 5-02.23 and 24 of Regulation S-X.

Since Mr. Simonellis' purchase of 13,260 shares of common stock has been paid by the issuance of a non-interest bearing note, this note receivable should be shown as a deduction of equity. Any other receivable related to stock purchases should also be accounted for as a reduction of stockholders' equity. Please revise.

Notes to Consolidated Financial Statements, Pages 65-70

Investments shown at cost in Note D should include the aggregate market value at the respective dates.

The data related to range per share and aggregate of the option and market prices for shares exercisable at December 31, 1968 and June 30, 1969 should be shown near [A8] the bottom of Note H.

Supplementary profit and loss information should be given at the end of the notes.

Notes to Financial Statements, Pages 82-86

Since the current maturities of long-term debt is in the amount of $1,372,106 in the July 31, 1969 balance sheet, it appears that the amount of $377,717 shown in Note 5 for approximate maturities on long-term indebtedness should be revised or reconciled.

Supplementary profit and loss information shown in Note 12 should be revised so that "Other" is changed to the appropriate account.

At least one copy of the a the [sic] accountants' reports should be manually signed in one of the definitive proxies filed with the Commission.

The last sentence in the headnote on Page 14 should be expanded to include reference to the six month period ended June 30, 1968.

A note to the statement of consolidated income of National should contain a pro forma income statement for the year ended December 31, 1968 and the six month periods ended June 30, 1968 and 1969. This statement should give effect to the pickup of National's interest in the earning of TSC on the basis of the common stock now owned and also to the dividends on the preferred stock now owned. Effect should be given to the interest expense applicable to the acquisition based on present value of notes to yield a return more in line with current interest costs. Effect to the revised rates on interest should be furnished in all applicable sections of the proxy. The pro forma net income should be included with the comparative per share date [sic] on Page 23.

The Financial statements of National should be furnished for 1964. To the extent that an explanation of this statement is needed it can be included in what is now Note (§) on Page 18.

Please furnish as supplemental information in detail the basis for the capital loss of $9,400,000 as indicated in Note (4) on Page 53.

Note G on Pages 66 and 67 should be expanded to include the due date of all long term debt.

Note H on Page 68 should be reference to Note (2) on Page 15.

Since individual financial statements of a filing company are not required in a proxy (See Item 15 of Schedule 14A of the Rules and Regulations under the Securities and Exchange Act of 1934) is assumed the financial statements and notes on Pages 71-72 will be omitted. If not the last sentence of the report of Ernst & Ernst on Page 71 should be deleted.

Sincerely,

/s/ REFORD BURNEY,
Reford Burney,
Branch Chief Division of Corporation Finance.

[A9] UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

[Titie omitted in printing.]

OPPOSING AFFIDAVIT OF RICHARD H. SCHAEFER

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, Richard H. Schaefer on oath states:

1. I make this Opposing Affidavit in opposition to Plaintiff's Motion For Partial Summary Judgment As To Liability of Corporate Defendants, on my personal knowledge, and I could testify to the matters stated herein if called upon to do so.

2. I am and have been at all times relevant to this action an officer and a member of the Board of Directors of [A10] TSC Industries, Inc., with offices at Chicago, Illinois. I have been President of Defendant, TSC Industries, Inc., since March 31, 1969.

3. As President of Defendant TSC Industries, Inc., and as determined by the Board of Directors, I was the chief administrative officer.

4. As President I have at all times possessed and exercised operational control of TSC Industries, Inc. I have been directly responsible, and exclusively accountable, to the Board of Directors for the orientation and implementation of all corporate policies including, for example, the hiring, firing and compensation arrangements of all personnel; the location, opening and closing of all retail outlets; the acquisition of merchandise for inventory and the marketing thereof; and the employment of all outside services, including legal services and financial relations with banks and other lenders.

5. All other officers and employees of TSC Industries, Inc., directly or indirectly report to me exclusively and I, in turn, report to the Board of Directors, exclusively.

[A11] 6. Beginning in the fall of 1969, Mr. Stanley R. Yarmuth and Mr. Allan B. Solomon, representing National Industries, Inc., entered into discussions with me looking toward a possible merger of the two corporations or an exchange of assets of TSC Industries, Inc., for securities of National Industries, Inc. I reported from time to time on the discussions to the directors of Defendant TSC Industries, Inc., and, in due course, the directors in principle approved of the proposed transaction which is now the subject matter of this action. When the essential terms of the proposed transaction had been determined, I then interviewed and, after inquiries, engaged the law firm of Friedman, Koven, Shapiro, Salzman, Koenigsberg, Specks & Homer to prepare the necessary documentation for the transaction and to prepare the Proxy Statement which is Plaintiff's Exhibit 1 in this action. At no time did TSC Industries, Inc., seek counseling from the law firm about the merits or terms of the proposed transaction, and at no time did the law firm or anyone associated with it proffer advice to Defendant TSC Industries, Inc., about the essential terms of the proposed transaction, other than to undertake the preparation of requested documentation and preparation of the Proxy Statement and assist in the consummation of the transaction.

[A12] 7. On six separate occasions, December 23 and 29, 1969, February 3 and 4, 1970, March 25, 1971, and August 24, 1971, at Chicago, Illinois, Plaintiff's counsel took my deposition upon oral examination. The transcript of that deposition, without exhibits, totals 644 numbered pages, but I was not fully examined about the subject matter of this Opposing Affidavit.

/s/ RICHARD H. SCHAEFER,
Richard H. Schaefer.

Sworn to and signed before me December 1, 1972.

/s/ KATHRYN W. GRICHI,
Notary Public.

[A13] UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

[Title omitted in printing.]

OPPOSING AFFIDAVIT OF ALLAN B. SOLOMON

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, Allan B. Solomon on oath states:

1. I make this Opposing Affidavit in opposition to Plaintiff's Motion For Partial Summary Judgment As To Liability of Corporate Defendants, on my personal knowledge, and I could testify to the matters stated herein if called upon to do so.

2. I am an attorney, licensed to practice law in the State of Kentucky. I am and have been at all times relevant to this action a Vice President of Defendant National Industries, Inc., with offices at Louisville, Kentucky.

[A14] 3. During the regular course of my duties as a Vice President of Defendant National Industries, Inc., it was my responsibility to routinely receive and review the stock transfer reports on the Company's several classes of securities as made up and transmitted from time to time by the Company's transfer agents. At no time did I have any advance knowledge of any market transaction in the Company's common stock by Madison Fund, Inc. My sole knowledge of any transaction by Madison Fund, Inc., in the Company's common stock was after the fact and was derived from my observation of the stock transfer reports.

4. I have no knowledge of any past, present or future plan, program, schedule or formula of Madison Fund, Inc., for the purchase of the Company's stock.

5. On three separate occasions, March 25, and 26, 1970, and November 29, 1971, at Chicago, Illinois, and December 16 and 17, 1971, at Louisville, Kentucky, Plaintiff's counsel took my deposition upon oral examination. The transcript of that deposition, without exhibits, totals 558 numbered pages, [A15] but I was not fully examined about the subject matter of this Opposing Affidavit.

/s/ ALLAN B. SOLOMON,
Allan B. Solomon.

Sworn to and signed before me December 4th, 1972.

/s/ ALICE C. ROSSELL,
Notary Public, State-At-Large, Kentucky.

[A16] UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division
[Title omitted in printing.]

OPPOSING AFFIDAVIT OF STANLEY R. YARMUTH

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, Stanley R. Yarmuth on oath states:

1. I make this Opposing Affidavit in opposition to Plaintiff's Motion For Partial Summary Judgment As To Liability of Corporate Defendants, on my personal knowledge, and I could testify to the matters stated herein if called upon to do so.

2. I am and have been at all times relevant to this action President of Defendant National Industries, Inc., and a member of its Board of Directors, with offices at Louisville, Kentucky.

[A17] 3. During the years 1968 and 1969 I learned that Madison Fund, Inc., had from time to time purchased common stock of Defendant National Industries, Inc. At no time did I have any advance knowledge of any market transaction in the Company's common stock by Madison Fund, Inc. My sole knowledge of any transaction by Madison Fund, Inc., in the Company's common stock was after the fact and was derived from my observation of stock transfer reports shown to me from time to time by Mr. Allan B. Solomon, Vice President of Defendant National Industries, Inc. My best recollection is that on at least one occasion Mr. Edward A. Merkle told me that Madison Fund, Inc., had purchased some common stock of the Company.

4. I have no knowledge of any past, present or future plan, program, schedule or formula of Madison Fund, Inc., for the purchase of the Company's common stock.

5. Early in 1969 I observed that the market price of common stock of Defendant National Industries, Inc. was declining. I believed that the Company had a bright future and that the prices reported in market transactions in the spring of 1969 were unrealistically low when measured against the future earning capacity of the Company. I made the decision that the Company would purchase some of its own stock in the open market. I then [A18] personally directed the placement of each order to purchase National common stock for the Company until September 17, 1969. Each such decision made from time to time to purchase the Company's common stock was made by me. At no time did I discuss with Mr. Edward A. Merkle or with any other representative of Madison Fund, Inc. any decision to acquire common stock of the Company in the market.

6. Although I became Chairman of the Board of Directors of TSC Industries, Inc., on March 31, 1969, I have never acted as its chief executive or chief administrative officer.

7. On three separate occasions, October 20 and 21, 1970, at Louisville, Kentucky, on September 10, 1971, at Chicago, Illinois, and on December 16 and 17, 1971, at Louisville, Kentucky, Plaintiff's counsel took my deposition upon oral examination. The transcript of that deposition, without exhibits, totals 425 numbered pages, but I was not fully examined about the subject matter of this Opposing Affidavit.

/s/ STANLEY R. YARMUTH,
Stanley R. Yarmuth.

Sworn to and signed before me December 11th, 1972.

ALICE C. ROSSELL,
Notary Public, State-At-Large, Kentucky.

[A19] UNITED STATES DISTRICT COURT
For the Northern District of Illinois
Eastern Division

[Title omitted in printing.]

OPPOSING AFFIDAVIT OF BRUCE ZALMAN

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, Bruce Zalman on oath states:

1. I make this Opposing Affidavit in opposition to Plaintiffs' Motion For Partial Summary Judgment As To Liability of Corporate Defendants, on my personal knowledge, and I could testify to the matters stated herein if called upon to do so.

2. I am an attorney, licensed to practice law in the State of Kentucky. I am on the legal staff of Defendant National Industries, Inc., with offices at Louisville, Kentucky.

[A20] 3. The Exhibit attached to this Opposing Affidavit was prepared by me and reproduced under my supervision and control. The Exhibit consists of two graphs. The horizontal reference for both graphs is the months for the years 1968, 1969 and 1970. The vertical reference for the upper graph is the closing market price for the indicated security. The vertical reference for the lower graph is the volume of shares of National Industries, Inc., common stock traded during the indicated month. *The Wall Street Journal* is the source of the data as to closing market prices and as to total volume of shares traded.

4. Referring to the upper graph, the blue jagged line represents the fluctuations and trend in market prices of National Industries, Inc., common stock ("NII common stock") during the years 1968, 1969 and 1970. The line is plotted against the indicated market prices which are the closing market prices for the first trading day of the month and for the fifteenth day

of the month if a trading day, if not, the first trading day thereafter on which market prices were being reported. The red jagged line represents the fluctuations and trend in market prices of National Industries, Inc., preferred stock, $1.25 Series B, similarly plotted. The black jagged line represents the fluctuations and trend in market prices of National Industries, Inc., warrants, similarly plotted.

[A21] 5. Referring to the lower graph, the purple overlay, if any, on a bar represents the number of shares of National Industries, Inc., common stock purchased in the indicated month by Madison Fund, Inc. The green overlay, if any, on a bar represents the number of shares of National Industries, Inc., common stock purchased in the indicated month by National Industries, Inc. The sources of the volumes for each of these companies are documents heretofore produced and identified in this action.

6. Plaintiff's counsel have not taken my deposition in this action.

/s/ BRUCE ZALMAN,
Bruce Zalman.

Sworn to and signed before me December 4th, 1972.

/s/ ALICE C. ROSSELL,
Notary Public,
State-At-Large, Kentucky.

OVERSIZE FOLDOUT(S) FOUND HERE IN THE PRINTED EDITION OF THIS VOLUME ARE FOUND FOLLOWING THE LAST PAGE OF TEXT IN THIS MICROFICHE EDITION.

SEE FOLDOUT NO. 1

UNITED STATES DISTRICT COURT
For the Northern District of Illinois
Eastern Division

[Title omitted in printing.]

OPINION AND ORDER

Entered May 21, 1973

The opinion of the District Court denying partial summary judgment as to the liability of Petitioners is reported at 361 F. Supp. 108 (N. D. Ill. 1973). A complete copy of that opinion is included in Appendix B to Petitioners' Petition for Writ of Certiorari, and is not reprinted here.

UNITED STATES DISTRICT COURT
For the Northern District of Illinois
Eastern Division

[Title omitted in printing.]

OPINION AND ORDER

Entered August 10, 1973

The opinion of the District Court amending its opinion and order of May 21, 1973 is unreported. A complete copy of that opinion is included as Appendix C to Petitioners' Petition for Writ of Certiorari, and is not reprinted here.

UNITED STATES DISTRICT COURT
For the Northern District of Illinois
Eastern Division

[Title omitted in printing.]

Letter from Prof. Ernest Folk, III to Arnold I. Shure, Esq. (Exhibit A to Plaintiff's Reply to Corporate Defendants' Objections Concerning Plaintiff's Motion Under 28 U. S. C. § 1292(b), filed July 24, 1973.)

University of Virginia,
Charlottesville, Virginia 22901,
School of Law.

July 19, 1973

Dear Mr. Shure:

I have received from you and your co-counsel a copy of the memorandum opinion and order dated May 21, 1973, of Judge McLaren of the United States District Court for the Northern District of Illinois in the case of *Northway, Inc.* v. *TSC Industries*, No. 69 C 2513. The case involves, among other matters, the question of the proper construction of Section 144 of the Delaware General Corporation Law, Del. Code Ann. tit. 8, § 144. This provision, entitled "Interested directors; quorum," states the conditions under which a contract or other transaction involving conflicts of interests of directors or officers may be validated. In his opinion construing this provision, more specifically Section 144(a)(1), Judge McLaren quotes the following passage from my article, *Corporation Law Developments—1969*, 56 Va. L. Rev. 755, 782 (1970):

> "Thus, if three of four disinterested directors on a nine-man board vote for the transactions [*sic*], it is validated. In this hypothetical, it is assumed that the five interested directors (who are permitted under these [Delaware] statutes to participate in and vote at the meeting) would have voted for the transaction, so that the resolution formally passes by a vote of eight to one."

You have requested that I clarify my views on the issue which is presented in the case itself and in the quoted passage from my article.

As I understand it, the following factual situation raises the interpretative issue on which Judge McLaren has ruled. The board of directors of TSC Industries, Inc. at a meeting purportedly adopted resolutions approving a plan of sale of assets and liquidation of TSC. The board consisted of ten directors. Eight directors attended. Four directors who are assumed to have no interest in the transaction (within the meaning of Section 144) voted in favor of the resolutions; the remaining four directors abstained from voting; and there were no negative votes cast. Under Section 275(a) of the Delaware General Corporation Law, the procedure for dissolution of a corporation requires that a resolution to that effect must be adopted "by a majority of the whole board. . . ." According to Judge McLaren's opinion, plaintiff, who attacks the transaction, "has failed to show that the transaction was not validly approved by the TSC board. . . ." Memo. Op. p. 16.

The question on which you seek clarification of my views is whether the affirmative votes of disinterested directors, comprising less than a quorum of the board of directors, will be sufficient to approve a resolution calling for the dissolution of a corporation when Section 275(a) requires action "by a majority of the whole board." In my view, a resolution of dissolution adopted by less than a majority of the board of directors (even though those directors have no "interest" in the dissolution) is not effective action by the board for purposes of complying with the specific mandate of Section 275(a). I do not consider that the statement in my article implies or suggests that such a resolution has been effectively approved, and, indeed, that the implications of my statement are the other way. It is this issue which I now analyse.

As I have expressed it in my text on Delaware Corporation Law, the "purpose and effect [of section 144] is to validate a contract [or other transaction] between a corporation and one or more of its directors or officers, or between a corporation and other entities which are linked by common directors or officers, if any one of three statutory tests is met," including the test of distinterested director approval. Folk, *The Delaware General Corporation Law: A Commentary and Analysis* 75 (1972). In my view this is the only purpose of a statute such as Section 144, namely that it states three disjunctive tests for determining whether corporate action, otherwise voidable for a conflict of interests, may nonetheless be sustained as valid against a charge that it is tainted by breach of duty on the part of directors or officers engaging in a transaction with the corporation, *i.e.* a transaction in which they stand on both sides of the transaction.

My view is that two determinations must be made when one is confronted with a question such as the present case presents. The first issue is whether there was *effective* corporate action. This involves the questions whether a quorum of directors was present, and if so whether a lawful majority of the quorum approved the resolution. "Effectiveness" of director action refers to compliance with such formalities. Stated otherwise, director action can be formally effective even though it is challengeable for a conflict of interests. The second issue is distinct and separate from the first: assuming that action taken by the board of directors is formally effective, may that action be challenged, on equitable grounds, because the directors (or some of them) had a personal interest in the outcome of the vote. The common law (more specifically judge-made rules of equity) invalidated transactions under varying tests. See generally, Marsh, *Are Directors Trustees?*, 22 Bus. Lawyer 35 (1966). The confusion incident to these differing tests and their varying application, prompted legislatures to enact statutes such as Delaware's Section 144 and statutes adopted earlier in other states, such as California, New York, North Carolina and South Carolina. The

purpose of all of these statutes is to state clearer and more specific tests as to the validity of transactions otherwise questionable for a conflict of interests on the part of the directors.

My position is that Section 144 of the Delaware Corporation Law does not state rules as to formal effectiveness of action by a board of directors. It states rules as to when formally effective action may or may not be challenged because of a conflict of interests. To be specific, Section 275 declares the formalities necessary to adopt an effective resolution of the board of directors calling for dissolution of a corporation. That formality is approval "by a majority of the whole board." Section 144(a)(1) does not undercut this statutory requirement for effective action by the board of directors. The role of Section 144, in my judgment, is to predict and determine when formally effective action under Section 275(a) will be held valid or voidable, under Section 144, as the case may be, because of an alleged conflict of interest.

I believe that my statement in the Virginia Law Review article is consistent with the foregoing analysis. I expressly assumed that the interested directors voted for the transaction; my statement, as to the hypothetical, is that "the resolution formally passes by a vote of eight to one." This negates any suggestion that I believed, either then or now, that a minority of disinterested directors could, by their votes alone, formally and effectively adopt a board resolution, at least not in the case where a statute expressly requires a majority of the entire board.

In summary, Section 144(a)(1) states when board action may be immune from challenge on the ground that some board members have a conflict of interests. It does not state when and under what circumstances board action will be formally effective. For that, one must look elsewhere in the statute, *e.g.*, Section 275(a) (dissolution) or Section 141(b) (general rule as to vote by board), or to provisions of the certificate of incorporation or by-laws as permitted by the statute.

There are several subsidiary points to be made.

1. I believe that my position conforms to canons of construing Delaware statutes. First, a statute such as the General Corporation Law which was enacted as a single comprehensive codification of law should be construed in such a way that all of its provisions can be given effect and still harmonize with each other. Cf. *Blaustein* v. *Standard Oil Co. of Indiana,* 44 Del. (5 Terry) 145, 155, 56 A. 2d 722, 777 (Del. Super. Ct. 1947); *DuPont* v. *Mills,* 39 Del. (9 W. W. Harr.) 42, 62, 196 Atl. 168, 177 (Del. Ct. en banc 1937). The suggested reading of Sections 275(a) and 144(a)(1) achieves this: Section 275(a) declares what director action is necessary for an effective resolution recommending dissolution to the stockholders, while Section 144(a)(1) states one of the conditions which, if met, will immunize a formally effective resolution from challenge for conflict of interests. Secondly, even if there is a possibility of conflict or disharmony within the statutory scheme, a more specific statute should control over a more general provision. *Hamilton* v. *State,* 285 A. 2d 807, 809 (Del. Sup. Ct. 1971); *Singewald* v. *Girden,* 36 Del. Ch. 152, 163, 127 A. 2d 607, 614 (Del. Ch. 1956). Thus, Section 275(a), stating a specific rule for a particular class of transactions (proposing a dissolution for stockholder approval), must take precedence over Section 144(a)(1) (stating a general rule applicable to a wide panoply of transactions, of which a dissolution resolution is but one type).

2. The view that only disinterested directors, even though less than a quorum of the board, may take effective action to approve a dissolution recommendation presents an anomaly. It logically implies that dissolution could be effectively approved at the board level by the affirmative vote of one disinterested director while nine interested directors abstain. Such a result is even more anomalous under the rule of *Dillon* v. *Berg,* 326 F. Supp. 1214 (D. Del.), *aff'd per curiam,* 453 F. 2d 876 (3d Cir. 1971) that "a director who is present and does not vote at all on the resolution is counted in the negative for the purpose of

determining whether the resolution has been carried by a majority vote." 326 F. Supp. at 1227. It would follow that the hypothetical resolution had received one affirmative vote, and nine (constructively) negative votes—a result radically inconsistent with Section 275(a)'s requirement of a vote by a majority of the whole board. The same reasoning would apply in the actual case about which you have inquired. Under the court's apparent reading of the Delaware law, coupled with the rule of *Dillon* v. *Berg, supra,* the resolution received four affirmative votes, plus four (constructively) negative votes, so that the purported action is ineffective on two grounds: (1) there is no majority of the whole board, as Section 275(a) requires, and (2) in any event, there is a tie vote which fails to carry a resolution. See *Dillon* v. *Berg, supra.*

3. Counsel sometimes take the position that interested directors should not attend (for quorum purposes) or vote at a meeting in respect of a transaction in which they have an interest. It might be argued that the construction of Sections 275(a) and 144(a)(1) encourage such participation. Whether or not it may do so—and whether or not that result is necessarily undesirable—Section 275(a) does require a majority of the entire board to recommend dissolution of the corporation, and Section 144 specifically anticipates that interested directors may be present at meetings and may vote on transactions in which they have an interest. Indeed, Section 144(a)(1) contemplates interested director participation to the extent of fully disclosing the extent of the director's interest and the material facts relating to the transaction.

If you desire to do so, you may make available this letter, or copies thereof, to any judge or any counsel in the litigation, as you may deem necessary.

Sincerely,

/s/ Ernest L. Folk, III,
Ernest L. Folk, III,
Professor of Law.

ELF/kbb

II.

COURT PAPERS IN THE SEVENTH CIRCUIT

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

[Title omitted in printing.]

RELEVANT DOCKET ENTRIES

10/17/73 Filed original record on appeal.

12/28/73 Filed Appellant Northway's brief.

1/25/74 Filed Appellee Corporate Defendants answering brief.

2/20/74 Filed S. E. C.'s motion for leave to file brief as amicus curiae, and S. E. C.'s proposed amicus brief.

2/27/74 Entered order granting S. E. C. leave to file brief as amicus curiae.

3/5/74 Filed Appellant Northway's reply brief.

3/5/74 Filed Joint Appendix, Vols. I, II, III (Parts 1 and 2).

3/20/74 Filed S. E. C.'s amicus curiae brief.

3/27/74 Filed Corporate Defendants' answering brief to S. E. C.'s amicus curiae brief.

9/6/74 Filed Appellant Northway's additional authority.

9/12/74 Oral Argument heard and taken under advisement.

3/5/75 Entered final judgment order reversing denial of summary judgment in favor of Plaintiff and against Corporate Defendants, and remanding for further proceedings in accordance with opinion of Court. Further ordered that costs are awarded to the Plaintiff and against Corporate Defendants.

3/5/75 Filed opinion by Judge Swygert.

3/21/75 Filed Appellee Corporate Defendants' motion to stay mandate.

3/25/75 Filed Appellant's response to motion to stay mandate.

3/27/75 Entered order staying mandate for 30 days.

4/18/75 Filed Appellee Corporate Defendants' motion to extend stay of mandate.

4/22/75 Entered order extending mandate for stay to 5/23/75.

5/27/75 Filed notice of filing Petition for Certiorari, U. S. Supreme Court No. 74-1471.

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

[Title omitted in printing.]

FINAL JUDGMENT ORDER

Entered March 5, 1975

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby: The order of the district court granting summary judgment in favor of the Schmidt defendants is AFFIRMED. The denial of summary judgment in favor of plaintiff Northway and against defendants National Industries, Inc. and TSC, Inc. on the issue of liability is REVERSED, and the cause is REMANDED for further proceedings, in acordance with the opinion of this court as of this date.

IT IS FURTHER ORDERED that the costs on this appeal be awarded as follows: To the Schmidt defendants and the Schmidt Family Foundation against Northway, Inc.; and to Northway, Inc. against National Industries, Inc. and TSC Industries, Inc.

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

[Title omitted in printing.]

OPINION

Entered March 5, 1975

The opinion of the Court of Appeals entered on March 5, 1975 is reported at 512 F. 2d 324 (7th Cir. 1975). A complete copy of that opinion is included as Appendix A to Petitioners' Petition for Writ of Certiorari, and is not reprinted here.

III.

EXCERPTS OF DEPOSITION TESTIMONY

IN THE UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division
[Title omitted in printing.]

The deposition of SAUL R. FELLARS, a witness in the above-entitled cause, called by the defendants for examination, taken pursuant to notice and pursuant to the Rules of Civil Procedure for the United States District Courts pertaining to the taking of depositions; taken before Lucile E. Moore, C. S. R., a notary public in and for the County of Cook and State of Illinois at Suite 1600, 6 North Michigan Avenue, Chicago, Illinois, commencing at 1:00 o'clock p.m. on November 16, 1970.

* * * * *

[26] Q. At the time you sold the drugstores had you formed Northway, Inc. then?

A. Yes, I am sure I had at that time.

Q. Do I understand that since you sold the drugstores you have had no business activity other than what may be involved in your job as president of Northway, Inc.?

A. That is not correct.

Mr. Shure: Just a minute. That is not a correct summation of the witness' testimony.

By Mr. Fiske:

Q. May I ask you, Mr. Fellars, whether since you sold the Sun Drug Stores in October of 1959 you have had any other business activity apart from being president of Northway, Inc.?

A. I have had.

Q. Can you describe that for us.

A. In so doing I would be giving you a resume of all my assets.

I will ask my attorney at this point whether [27] or not I should answer a question of this type.

Mr. Shure: I see no objection to a general statement as to your being an investor of real estate.

If counsel has some particular reason for knowing what each investment is he can so state and we will then consider it.

By Mr. Fiske:

Q. Let me start by asking you, Mr. Fellars, whether or not the business activities which you have been engaged in since you sold the Sun Drug Stores have all involved real estate?

A. Let's say most of it has. There have been probably other activities besides this, but I just don't recall what they are right now.

I am sure there have been other things I have been into besides real estate but principally real estate.

Q. If we characterize it as being predominantly in the real estate field, would that be accurate?

A. I would say, yes.

Q. Over the past ten years?

A. Yes, associated with real estate.

Q. To the extent that your business in the last [28] ten years has not been in the real estate area, have you held any position as an employee of any corporation, other than Northway?

A. Will you restate the question?

Mr. Fiske: Will you read the question, please.

(Question read by the reporter.)

By the Witness:

A. Not that I recall.

By Mr. Fiske:

Q. Have you been a director of any corporation in the past ten years?

A. Besides Northway?

Q. Are you a director of Northway?

A. I am a director of Northway.

Mr. Shure: Excuse me a moment. Correct me if I am wrong; but I understood you were saying, outside of the real estate business investments, your question is, have you held any position, is that right?

I don't know if he has any corporations, any other corporations in the real estate business, but I think we have gone far enough into the details of each one, unless it has some relation [29] to this matter.

Mr. Fiske: I will be glad to limit my question at least to the time being with respect to the directorship, to corporations which are not involved in the real estate business.

Q. Can you answer it on that basis, or would you like to hear it again?

A. No, no. I may be a director of another corporation, and I'm not really prepared to say right now whether I am or not, that is not connected with the real estate business.

Q. Do you have the name of that corporation in mind?

A. Oh, yes.

Q. Can you tell us the name of that corporation.

A. Carlson Laboratories, Inc.

Q. What is the nature of its business?

A. It is in the vitamin business.

Q. Have you ever been a director of Carlson Laboratories?

A. I really don't know.

Q. Is that a company with which you had a business relationship while you owned the Sun Drug Stores?

A. No.

[30] Q. In other words, none of your drugstores ever did any business with Carlson Laboratories?

A. No.

Q. I think you said that you and your wife owned all of the stock of Northway, Inc.?

A. I am fairly sure that I am right.

Q. You don't know of any other stockholders?

A. If so, it will be another member of the family owning some. I am not sure whether in this particular corporation or not there is a third stockholder.

Q. Has there ever been a stockholder of Northway, Inc. other than a member of your family?

A. No.

Q. Can you give us the names of the other officers of Northway?

A. I think in this case that myself, that I, Saul Fellars, is president and treasurer. And my wife is secretary and vice president.

Q. Could we have her name?

A. Carolyn Fellars.

Q. Are there any other officers besides you and your wife?

A. No.

Q. Have there ever been?

[31] A. No.

Q. At the present time does Northway, Inc. have any assets other than the two pieces of real estate which you described?

A. Yes.

Q. Can you give us a general description of those assets.

A. No. I don't know what they are without going to the books and records to find out what they are. There are others but I don't know what they are at this moment.

Mr. Shure: Excuse me please, will you read back that last question?

(Question read by the reporter.)

Mr. Shure: Other than the real estate?

Mr. Fiske: He answered, he said he couldn't, so the question is academic.

By Mr. Fiske:

Q. Mr. Fellars, can you tell us in general terms what kinds of assets Northway, Inc. holds other than real estate?

A. It holds 200 shares of TSC Industries.

Q. Anything else?

A. Yes.

Q. Can you give us a general description of [32] the kinds of assets other than the real estate and the 200 shares of TSC?

A. It owns other stock, I can't tell you what they are. I don't know without looking them up.

Q. Has Northway, Inc., during the period of its existence, from time to time made purchases and sales of stocks?

A. Yes, it has.

Q. Can you give us in general terms, as of the present time, a statement as to—in terms of percentages, if you can—the relevant percentage of the total Northway assets which are made up of the two pieces of real estate which you hold?

A. No.

Q. Can you tell me whether it is more than 50 per cent?

A. Not without going to the books and records and finding out.

Q. Can you tell us whether it is more than 75 per cent?

A. Not without going to the books and records to find out.

Q. In other words, as you sit here, you can't give us a general indication of the percentage of the [33] assets of Northway which are made up of the two pieces of real estate?

A. You are asking me to guess, and I refuse to guess.

Q. No, I am just asking for your best information as you sit there.

A. I don't know without going to the books and the records, as to just how much each one is.

Q. Has there been any point in time over the last five years when the stocks owned by Northway made up more than 50 per cent of the assets?

A. I don't really know.

Q. Is there any person or firm which acts as an advisor to Northway in connection with its stock investments?

A. Well, I subscribe to stock services, and I use them, the stock services.

Q. Apart from what you get in the mail, is there any firm or person whom you have consulted at any time in the past five years with respect to purchases or sales of stocks by Northway?

Mr. Shure: Will you try to put some sort of limitation on the breadth of that question? In order to help the witness, can you give him [34] some idea of what you are trying to find out? That is a very broad question.

Would you indicate what kind of people so the witness will have some idea what you are talking about.

By the Witness:

A. Are you speaking of professional people?

By Mr. Fiske:

Q. Yes. Let's start with that.

A. Whether I hire any professional people to advise Northway in their stock purchases?

Q. Yes.

A. No.

Q. And let me ask you the second question:

At any time in the past five years has Northway ever paid any person or firm for any advice which has been given to Northway in connection with stock purchases or sales?

A. Would you call Value Line a person, or would you call them a service? Northway has paid Value Line, and whether you would call them one or not I don't know.

Q. Apart from Value Line is there any person or firm which has been paid for investment advice?

[35] A. From time to time I purchase advisory services on a short-term basis, such as one of mine now is Capital Gains

Reports. Whether Northway pays for that or one of my other corporations I don't know.

Mr. Shure: Mr. Fiske.

Mr. Fiske: Yes?

Mr. Shure: Can I ask you to try to limit your questions? I am having a little trouble understanding it too. I can see circumstances under which compensation was made to somebody, possibly, I don't know, because I know nothing about the other assets of the corporation, but I can conceive of a situation of something being paid indirectly. And I was hoping, in narrowing your question you could remove the ambiguity which I see at the present time. And there is a very broad ambiguity.

Mr. Fiske: Well, I don't think we have a question pending at the moment, Mr. Shure. But I have your comments and I will take them into account in my future questioning.

• • • • •

[38] By Mr. Fiske:

Q. Can you give us a figure, Mr. Fellars, and I am now talking about the period of time, let's say, from January 1, 1968 through January 1, 1970, during that two-year period, talking in terms of the way you personally spent your business day, can you give us a figure as to the percentage of your time generally during that period that was devoted to investments in stocks as opposed to investments in real estate?

A. I haven't kept any record of this at all so I have no knowledge of what percentage. You can make the percentage vary a great deal, and I still wouldn't know whether you are right or wrong, if I did answer I wouldn't know.

Q. I am just asking you, as you sit here today, to give us your best recollection as to the amount of your time spent during that period—

A. I couldn't do it without guessing.

• • • • •

[51] By Mr. Fiske:

Q. Now, was that also true—

A. I would have a qualification on that answer, though. And that is, that I would generally know that one of the corporations owned the stock. I may not know which one owned it. This I never know because I don't keep in my mind as to which corporation owns which stock.

But I do know generally what all of them own totally.

Q. During this period of time, January 1, '68 to the present time, have you been the one who was responsible for making the investment decisions on behalf of Northway?

A. I am.

Q. Is that also true of the other corporations [52] in which you and your family own more than a 50 per cent stock interest?

A. I am.

Q. Let me ask you this question one more time so I am sure we all understand it: As you sit here in that chair right now, are you aware of any case in which any one of these corporations in which you and members of your family own more than 50 per cent of the stock, owned at any time a stock of a corporation which at that time had more than 10 per cent of its stock owned by National Industries?

A. I don't know.

Mr. Shure: If you don't understand that question I would like to have it read back.

The Witness: Well, read it back then, to be sure I do understand it. I thought I did, but if I don't then let's have it again.

(Question read by the reporter.)

Mr. Shure: You are excluding Northway?

Mr. Fiske: I meant to include Northway. I am including all of them, including Northway.

Mr. Shure: Are you including or excluding TSC? We have a proxy statement here. I am getting a little confused.

• • • • •

[55] By Mr. Fiske:

Q. What is the trade date of the other transaction?

A. January 20, 1969.

Q. All right, thank you.

This document which we have just been looking at, Mr. Fellars, reflects, does it not, two separate purchases of 100 shares each of TSC Industries?

A. It reflects two separate purchases, of TSC Industries.

Q. And the first trade date was December 16, 1968?

A. That is what I said.

Q. Were you the one who made the decision to purchase 100 shares of TSC Industries on behalf of Northway on that date?

A. I am.

Q. Did you consult with any other person employed by Northway before making that decision?

A. I don't remember whether I did or not.

Q. Did you consult with anyone outside of North- [56] way before you made the decision to buy the 100 shares?

A. I don't remember whether I did or didn't.

Q. Can you tell us why it was that you decided to buy the 100 shares of TSC Industries?

Mr. Shure: Just a minute, please.

(Discussion off the record.)

Mr. Shure: Unless you can clarify that I am objecting on the grounds that this is not a proper area of examination. It is difficult to understand, what difference does it make whether he bought it, whether he found it, inherited it, or whether he bought it because he had money to invest—I don't know why he bought it.

I just don't think it is material to his complaint in this action, or could possibly be material as to why he bought the stock and why he made this investment rather than stock in General Motors or anything else. It is wholly outside the issues.

Mr. Fiske: Are you telling Mr. Fellars not to answer that question?

Mr. Shure: Are you insisting on an answer?

Mr. Fiske: Yes.

[57] Mr. Shure: Why he bought it. Well, I will let him answer, but I just think we are out of the ball park.

You can answer the question.

By the Witness:

A. The question is, why did I buy TSC Industries?

By Mr. Fiske:

Q. Yes.

A. I had received a recommendation from Value Line, as a recommended stock, to buy TSC Industries. And after looking over their financial statements, and inasmuch as it was in the retail business, which I'm very familiar with, or let's say I am familiar with, not very familiar with, I looked at it as being an under-valued stock at that time. So I purchased it.

Q. What was there about TSC which led you to the conclusion that it was under-valued?

A. I wouldn't remember now without going over their records and having some time to restudy it as I had then. At that time I had the time to study it. And I would want that time to study it again before answering a question of that type.

Q. Can you tell us what documents, other than Value Line report, that you reviewed before making [58] a decision to purchase the TSC stock.

A. There are two that I probably had, I am pretty sure I had. One was the 1968 financial statement. These were purchased in '68 so I must have had the 1967 financial statement at one time.

And a Standard and Poor's statement. If I had others, I don't remember at this time.

Q. Do you actually recall having the 1967 financial statement and the Standard and Poor's statement?

A. No, I told you that I probably had them.

Q. Do you have any recollection of having any other documents?

A. Not right now, I don't.

Q. Did you obtain any further information about TSC Industries between December 16, 1968 and January 20, 1969, when the record indicates that you made the second purchase?

A. I don't recall if I did or didn't.

Q. Can you tell us what led you to make the second purchase of 100 shares of TSC?

A. I couldn't tell you at this time without studying the statements and the figures, and so forth.

Q. Can you tell us what your understanding was at the time you made the first purchase of the TSC [59] Industries stock as to what, if any, role Mr. Charles Schmidt played in the management of TSC Industries?

A. Will you re-read the question?

(Question read by the reporter.)

By the Witness:

A. I don't know. I never did know Mr. Charles Schmidt. I know that Mr. Schmidt had a controlling interest, inasmuch as he owned about one-third of the company. And he had been with the company for a long time and he was responsible for the good profits, the profits that was shown by TSC Industries, and this satisfied me.

Q. Was it your understanding that Mr. Schmidt was responsible for the profits shown by TSC in the financial statement you looked at before you made the purchase?

A. I looked at it that if a man runs a company then that he is the man who is responsible mainly for the profits the company makes.

Q. Does that mean that the answer to my last question is "Yes"?

A. Will you ask your question again?

[60] Mr. Fiske: Will you read it back, please.

(Question read by the reporter.)

The Witness: Re-read it again, please, a little slower.

(Question read by the reporter.)

Mr. Shure: May I object? I am sure there is a double meaning, which finally got through to me.

Are you asking whether he understood, without specifying any time, that Mr. Schmidt was responsible for the profits TSC had made during the period prior to his buying the stock, or are you asking him whether prior to his buying the stock he then understood that Mr. Schmidt had been responsible for the profits? Those are the two possibilities.

Mr. Fiske: I hope there is no confusion about this. All of my questions were directed at what Mr. Fellars understood at the time he made his first purchase of TSC stock in December of 1968.

Mr. Shure: I can see how the last question seems to change that.

[61] By the Witness:

A. I can't honestly answer that yes or no. I think it has to be answered in a different manner. I don't think it can be answered yes or no.

By Mr. Fiske:

Q. Let's make sure we don't have any confusion about the question. The question is simply whether you understood at the time you made your decision to buy TSC Industries stock in December of 1968 that Mr. Schmidt was responsible for the profits of TSC which were reflected on the financial statement which you looked at before you made your decision to purchase.

A. Again, I can't answer that yes or no. I can answer it but I can't answer it yes or no.

Q. Well, answer it the best you can.

A. The man who runs the company normally is the man who I hold responsible for making a good showing in the company. There are other people in the company too who help do that, and for this reason I can't answer yes or no. But mainly, it is the man who runs the company, and he directing these other people that creates the profit.

• • • • •

[71] By the Witness:

A. That is the only one I recall at this moment.

By Mr. Fiske:

Q. In the course of your duties for Northway and these other corporations in which you and your family own more than 50 per cent of the stock, do you try to keep generally informed of what is going on in the business community by reading financial publications?

A. I read the Wall Street Journal. Does that answer it for you?

Q. Well, that's a start. Do you read magazines like business Week?

A. No.

Q. Forbes?

A. I read some Forbes, some of the issues, not all of them.

Q. Is it fair to say that you read whatever you think is necessary to keep you sufficiently informed to make the right kind of investment decisions for Northway?

A. No.

Q. It is not?

A. No, there are not enough hours in the day to do it.

• • • • •

[82] The Witness: I propose to be fair but I think this is an unfair question.

Mr. Fiske: We will let somebody else decide that, Mr. Fellars.

Q. Now let me go back and ask another question, which is whether or not you made an effort, in the course of your duties, your stock investment duties for Northway to keep generally familiar with the market prices of those stocks which Northway owned at any particular point in time?

A. Generally I keep familiar with what the market prices are.

Q. Are you familiar with what the market prices were for the stock of TSC Industries, Inc. during the period of January and February of 1969?

A. I was familiar in January and February, at that time, but I can't recall what each of the stocks are at different periods during the year.

At that time I was familiar with them.

Q. Are you saying that you can't tell us today what they were at that time?

A. No, I can't tell you exactly what they sold for at that time.

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UNITED STATES DISTRICT COURT
For the Northern District of Illinois
Eastern Division

[Title omitted in printing.]

The deposition of ERWIN E. NEMMERS, called for examination by the defendant National Industries, Inc., pursuant to the Rules of Civil Procedure for the United States District Courts pertaining to the taking of depositions; taken before Doris H. Leubrie, a notary public within and for the County of Cook and State of Illinois, at 134 South LaSalle Street, 17th Floor, Chicago, Illinois, on Friday, November 12, 1971, at the hour of 1:30 o'clock P.M.

* * * * *

[26] I can give you that, which is apparently the point you raised on asking me about the first sentence of 1(A). I want to be perfectly clear that answer relates to that part of TSC owned by non-National stockholders.

Mr. Fiske: If I could make a suggestion. I am a little confused because that sentence Mr. Morency refers to refers to the fair value of the assets, properties, and business of TSC on or about January 10, 1969.

The Witness: I can answer that one directly for you.

By Mr. Morency:

Q. If you please—in referring to paragraph 1(A), is your answer the same if we point out that, as it does, it refers to the January 30, 1969, date, is that correct?

A. I would like to be clear that my opinion of values here is the same throughout the year 1969 down to the time of the transaction.

Q. I respectfully suggest to you that isn't quite an answer to my question.

You testified that—rounding—you had an opinion as to value of fifty-one million dollars for the business, of TSC, assets, properties, and business, owned by non-National holders?

[27] A. That is correct.

Q. On January 30, 1969, is that correct?

A. That's right. That's the lower limit that I gave.

Q. Was that your opinion in the month of September, 1971?

A. I hadn't formulated my opinion in September, 1971. To begin with, I was on vacation during that entire month up in Alaska.

Q. When did you form your opinion as to the value you testified to?

A. The fifty-one million dollars, in the last two-week period.

Q. Do you have an opinion as to the value, the fair value of the assets, properties, and business of TSC on January 30, 1969?

A. Yes, I do.

Q. Will you state your opinion in dollars?

A. In the range between seventy-six million and ninety-three million, approximately—both numbers rounded.

* * * * *

[41] Q. I now have, Professor Nemmers, the same question with respect to paragraph number 4. which appears on page two of the Summary. What other portions of the Summary relate directly to the information shown in paragraph 4.?

A. Well, 4. is a separate statement in summary form of material drawn from the area supporting the other categories on that page. This is a wrap-up of the per share basis.

Q. Directing your attention to paragraph 4.(a), which reads: "Each share of TSC common gives up: $29.80" and then in the righthand side column "$36.40," does this express a range?

A. Yes, sir, it does.

Q. A bottom figure and a top figure?

A. Yes, sir. It is drawn from the range that I gave earlier, using the upper and lower limit, but translated to a per share basis.

Q. And that would translate back, I take it, to the 51 million dollar figure you expressed as being a rounded value?

A. Yes, sir. If those two should not tie, there is a mistake in arithmetic.

* * * * *

[51] The Witness: Will you read the question?

(Question read.)

A. That is true, only there is more than one preferred issue involved here. That is true as to TSC preferred where the valuation is on an arbitrage basis. This is not true of the National preferred which is valued fundamentally on a yield basis.

Q. Was it your position, then, Professor, as reflected in your Summary, that TSC preferred can only be valued properly on an arbitrage basis?

A. I give you clearly the reason why it is valued on an arbitrage basis because to value it on a yield basis, it would be to take a yield of less than four percent, which is so far removed from a practical yield it will sell on an arbitrage basis, which is higher. I am making the statement when preferred is involved in a yield or arbitrage situation, if the arbitrage situation is above the yield basis, it will always sell on an arbitrage basis.

* * * * *

[54] By Mr. Morency:

Q. My question to you was whether it was a term that you understood as used in this context?

A. What term?

Q. The term "fundamental position."

A. "Fundamental position" is a term that is used occasionally in finance, yes.

Q. What does it mean?

A. It's a general term intended to wrap up many concepts. It's a loose term. For example, when I say it will sell at least at its arbitrage value, "fundamental position" might take it above that.

Q. As used there, the term "fundamental position" would cover one or more other factors?

A. Yes, sir.

Mr. Morency: Gentlemen, that concludes my questions of the witness.

(Whereupon, a short recess was taken, after which the deposition continued, as follows:

Cross-Examination.

By Mr. Fiske:

Q. Referring to the document marked Defendant's Exhibit 6—

[55] A. Yes.

Q. On page two, the last sentence reads: "This is to be compared with a fair value of $29.80-$36.40 per share of TSC common."

A. Yes, sir.

Q. You see that sentence?

A. Yes, sir.

Q. I would like you to refer to the Interrogatory Answers, which are marked Defendant's Exhibit 5, and particularly to paragraph C. which appears on page three.

That paragraph contains a definition of the term "fair value," does it not?

A. Yes, sir.

Q. And when you use the term "fair value" on page two of Defendant's Exhibit 6, would it be fair to say you were using the definition which appears in paragraph C. on page three of Defendant's Exhibit 5?

A. Yes, sir.

Q. Do I also understand correctly that applying the range $29.80 to $36.40 per share of TSC common and multiplying that by the total number of shares of TSC common outstanding on January 30, 1960, produces that range of values of 76 million to 93 million [56] for the assets, property, and business of TSC you have testified to earlier?

A. No, sir.

Q. Let me try again.

Taking the range of fair value of $29.80 to $36.40 per share for the common—

A. Yes, sir.

Q. Multiplying that by the total number of shares of common outstanding, and also taking your opinion as to the range of fair values for the preferred and multiplying that times the number of shares of preferred outstanding, and adding those two totals together, does that produce the range of 76 million—

Mr. Block: I will object unless you say outstanding as of what date.

Mr. Fiske: January 30, 1969.

A. No. I was waiting for that.

By Mr. Fiske:

Q. The answer is no?

A. Yes. The number of shares used for the outstanding, as described in the—

Q. Regardless of the number of shares we are talking about at any point in time, as a matter of concept—

[57] A. Right.

Q. —the way you arrive at the total value for the business, assets, and property of TSC, as it is expressed in Defendant's Exhibit 6, is by multiplying the value which you give per share to the common times the number of common shares outstanding, multiplying the value you give to the shares of preferred times the number of preferred outstanding, and adding those two figures together?

A. Yes, sir.

Q. And just so there is no question about it, it is today, is it not, your opinion that the fair value of a share of TSC common stock on January 30, 1969, ranged between $29.80 and $36.40?

A. Yes, sir.

Q. And as of January 30, 1969, the fair value of a share of TSC preferred stock ranged between $22.55 and $27.30?

A. Yes, sir.

Q. I take it you have read this document which has been marked as Defendant's Exhibit 6?

A. Yes, sir; I prepared it.

Q. And is there any statement or number in that document as it has been presented to you today, other [58] than the correction which you made at the beginning of your testimony, which does not accurately express your opinion as of this moment?

A. No, sir. I tried to ferret out every error. If I passed over one, it's only—

Q. By inadvertence?

A. Completely, sir.

Q. And any error that may exist in here is only an error of a typographical or mathematical nature, is that right?

A. Yes, sir.

Mr. Fiske: That's all I have.

Mr. Block: We would like a moment to confer.

(Whereupon, a short break was taken).

Mr. Elson: We have no questions.

[188] IN THE UNITED STATES DISTRICT COURT

Northern District of Illinois

Eastern Division

[Title omitted in printing.]

The continued deposition of BLANCKE NOYES, resumed pursuant to adjournment at Suite 1500, 39 South LaSalle Street, Chicago, Illinois, on the 27th day of September, 1971 before Marcy Daniel, a notary public in and for the County of Cook and State of Illinois, commencing at the hour of 10:30 o'clock a.m.

• • • • •

[203] Q. Over what period of time?

A. I don't remember. Probably for the year 1969 to date, to October.

Q. Did you also observe the market prices of the National common stock during that period?

A. Yes.

Q. Why were the prices of the National common stock relative to your consideration?

A. Because the value of the warrants and in part, the value of the convertible preferred were not—dependent isn't right—but related to the price of the common stock.

Mr. Block: Off the record.

(Discussion off the record.)

Mr. Hamman: We have gone through this and we have identified all those documents, who wrote them, and so forth previously, did we not, I guess, on the transcript?

Mr. Rothschild: I don't think you can run a seminar here. I think you have to ask him questions and if, in the course of questioning, you want to put documents under his nose and have him look at them, I have no objection to that but I don't agree to any . . .

• • • • •

[211] Q. Can you tell me, sir, which proposal is referred to as Proposal A?

A. No, I really can't. As I say, these were Mr. Booth's notes which apparently he made during the course of our internal consideration of the matter I will be more help to you when you are giving me my notes.

Q. I will now show you a document which has been marked as Exhibit 377 and is a five-page set of handwritten notes containing, on the first page, a caption, "Current Prices," showing a column of 10/7/69 and 10/8/69. Do you recognize Exhibit 377, sir?

A. Not specifically, although it does it does resemble Mr. Booth's handwriting.

Q. Do you recall whether Mr. Booth discussed the contents of this material or exhibit with you?

A. I am sure he used in conferring with the partners of the firm involved in the matter.

Q. Now, Exhibit 378 is a one-page set of handwritten materials entitled, "Alternative Merger Proposal, National Industries—TSC Industries." Do you recognize it?

[212] A. Not specifically, although, once again, it does appear to be in Mr. Booth's handwriting.

Q. Can you explain the alternative proposals which are referred to in Exhibit 378?

A. I am afraid I cannot. We considered a number of possible alternatives, although, if you read down the page it would appear to explain what they are. These were Mr. Booth's ideas, probably, which he had formulated prior to going to the meeting with the partners who were going to reach the determination.

Q. When you refer to meeting with the partners, are you referring to a meeting of October 9 which included Mr. Yarmuth and others, or are you referring to some other meeting?

A. I am referring to meetings held between October 2 and October 9, not including either of them.

Q. Who was included in those meetings?

A. Various partners of the firm. I was in each of them. The older senior partner in corporate finance, Eugene Matalane—Eugene was in most, if not all of them. The managing partner of the corporate finance department, George Morris, M-o-r-r-i-s, was in a couple of them.

Q. Did Mr. Booth also attend these meetings?

[213] A. Mr. Booth attended them.

Q. Were these meetings held between October 2 and October 9?

A. Yes.

Q. Do you recall about how many meetings you had with these gentlemen during that span?

A. Not specifically.

Q. More than two?

A. I would say so. Three or four would be my guess.

Q. What was the nature of the discussion between you gentlemen during those meetings?

A. An attempt to analyze the relative merits of National Industries securities vis-a-vis TSC Industries securities.

Q. Now, the next document which I have had marked as Exhibit 379 is a one-page set of notes entitled "National Industries—TSC Industries." Do you recognize Exhibit 379?

A. Not specifically.

Q. Does that appear to you to be the writing of Mr. Booth?

A. It would seem to be the same handwriting.

Q. And I will show you a document which has [214] been marked as Exhibit 380, a handwritten set of materials entitled —well, it doesn't have a title, but the first line at the very top of the page reads, "NII has 435,000 TSC common and no TSC preferred." Do you recognize 380?

A. Not specifically. But, if I were to guess, I would say that was in the handwriting of Mr. George Morris, but I am not sure of that.

Q. I will show you a document marked as Exhibit 381, a handwritten set of materials with captions on two columns, the

first column, "NII" and the second column, "TSC." Do you recognize that document?

A. Not specifically.

Q. Does that appear to be Mr. Booth's work?

A. I can only compare handwriting, and I am not a handwriting expert, but it would appear to be similar handwriting to Mr. Booth's.

Q. Now, insofar as you are aware, Mr. Noyes, do each of these exhibits, 374 through 381, relate in one way or another to the evaluation which was made by you and your associates of the National Industries' proposal?

A. Yes, I would think so.

[215] (Noyes Deposition Exhibits 374 through 381, marked for identification, as of 9/27/71.)

Mr. Block: Off the record.

(Discussion off the record.)

By Mr. Block:

Q. Now, in the course of the consideration by you and your associates or partners of National's ability to handle its debt structure, were there notes or computations made?

A. Mr. Booth probably had some notes that he worked from, yes.

Q. I would like to show you now, a document which has been marked as Exhibit 382, being a two-page set of handwritten materials entitled, "National Industries Restatement of 1969 Debt Repayment Requirements." Do you recognize Exhibit 382?

A. Not specifically, although, it would appear to be in Mr. Booth's handwriting.

Q. Do you recall Mr. Booth discussing the contents of this exhibit with you?

A. Not specifically. As of two years ago he worked from those notes, I am sure, for discussion.

[216] Q. I will show you now Exhibit No. 383, which is a one-page set of notations or materials. The first item at the

top of the page is Item 1, "1970 Repayments." Do you recognize Exhibit 383, sir?

A. Yes, that is in my handwriting.

Q. Do you recall when you made these notes?

A. Probably at the October 2 meeting.

Q. Now, these notes relate to the matter of National's handling its debt structure, do they not?

A. Yes.

Q. Now, these notes contain certain information relating to various assets and subsidiaries of National such as Southern Tank Lines, Steel Coil and Kingwood Oil. Is the information referred to in these notes with respect to that items information which was supplied to you by National Industries during the October 2 meeting, if you recall?

A. To the best of my recollection, yes.

Q. Now, Item 1, at the top of the page reads, "1970 Repayments." What does that note refer to?

A. Debts coming due in 1970, I would assume.

Q. Is that National's debt?

A. National's, yes.

Q. Item 2 reads, "Longer Maturities. OK if [217] earnings hold at current levels." What does that second note refer to?

A. National's debt.

Q. Is the reference to "OK if earnings hold at current levels" your own conclusion?

A. Well, that was my conclusion as of the moment I wrote that, I gather.

Q. Was that based on something that had been told to you by the representatives of National who were present at that meeting?

A. Once again we are going back two years. I would suspect that that was an independent conclusion.

Q. Do you recall whether or not that conclusion was based on information given to you at that meeting by National representatives?

A. As I say, I don't have total recall as of two years ago, but I assure you that we were using not only what they told us at the meeting, but what we had also ascertained from published reports and other material.

Q. I will now show you a document which has been marked as Exhibit 384, containing five pages of typed material, the first page of which is entitled, "Pro Forma Combined Balance Sheet." In the first column [218] of figures is, "National Industries, Inc. and Consolidated Subsidiaries, June 30, 1969." Do you recognize Exhibit 384, Mr. Noyes?

A. Not specifically, but it could be—it could well be one of those we were working from.

Q. Do you recall whether this document was provided to you by National Industries, or whether that is a copy of a document which was provided to you by National Industries?

A. I would suspect that this document was provided to us by National Industries because it has an explanation of adjustments here referring to their initial suggested proposal.

Q. I will also show you a document which has been marked as Exhibit 385, being a bound volume of financial statements, National Industries, Inc., and consolidated industries, June 30, 1969. This document was in your files, Mr. Noyes. Do you recall whether this document was provided to you by National Industries?

A. I don't recall specifically, but I assume it was. It would not have been available otherwise, probably.

Q. Do you recall whether you made reference to this document in the course of arriving at the [219] suggestion for a transaction as you proposed on October 9 to the representatives of National?

A. I do not specifically.

Q. Now I will show you a document which has been marked as Exhibit 386 and which is a handwritten columnar worksheet entitled, "National Industries, Inc. Estimated Sources and Application of Funds, Year Ending December 31, 1969," with a

date of 10/1/69 in the upper corner. Do you recognize Exhibit 386?

A. I think so, and I believe this was provided us by National Industries.

Q. Was that provided to you at the October 2 meeting, if you recall?

A. I believe so.

Q. And do you recall making reference to this information in the course of arriving at the proposal for the October 9 meeting?

A. I assure you, we used all the information at our disposal in arriving at our decision. New material.

Q. Do I understand your answer to be that you do recall making reference to this particular information?

A. I wish I had better total recall. I can [220] only properly say I assume so.

Q. This was information which was pertinent to your inquiry concerning National's debt structure and its ability to handle the debt structure, is it not?

A. Yes, it would be related.

Q. Now, I will show you a document which has been marked Exhibit 387 which is a single-page handwritten set of notations without caption or date. Do you recognize Exhibit 387?

A. Most of the writing on it is my handwriting.

Q. What is the subject of this Exhibit?

A. Once again, the debt structure and debt retirement schedule of National Industries.

Q. Do you recall when you made this set of notes?

A. Not specifically.

Q. Was it made during the October 2 meeting?

A. I can't be sure.

Q. Is the information reflected in this exhibit information that was provided to you by National Industries?

A. Once again, I can't be sure of that. Plus [221] other sources of information.

Mr. Block: Let's take a short break.

(Brief recess.)

By Mr. Block:

Q. Now, in the course of the considerations by you and your partners or associates during the October 2 through October 9 period, did you give consideration to the common stock warrants of National Industries that were proposed for offer to the TSC stockholders?

A. Yes.

Q. What factors did you consider with respect to the proposed National common stock warrants?

A. Their market price, of course, as a listed security on the American Stock Exchange, reasonably actively traded. Their exercise price, the length of time they were to stay in existence—

Q. Did you consider any other factors in connection with your evaluation of the National warrants proposed to be issued to the TSC shareholders?

A. Well, obviously from the information you have presented me, we considered the relationship between price of the common and the exercise price of the warrants.

[222] Mr. Rothschild: Excuse me, Mr. Block. I think if he is going to consider that document it ought to be marked. I don't think that is proper, to put a document in front of a witness unless you are going to identify it.

By Mr. Block:

Q. You made reference to information which I presented you, Mr. Noyes. Were you referring to the typewritten document which is entitled "Comparison of AMEX Warrants"?

A. Yes.

Mr. Block: I will have that document marked as Exhibit 388 for the record.

(Whereupon Noyes Deposition Exhibits 382 through 388 were marked for identification, 9/27/71.)

By Mr. Block:

Q. Now, from prior testimony by deponents in this case, Mr. Noyes, I understand that that particular document, except for the last column of it, which is entitled "Warrant Price as a Per Cent of Common Market Price," and except for the handwritten computation at the very bottom, which reads, "Average—ten other issues, 35 per cent," was prepared by [223] Mr. Ivan Greenspan, a member of the National Industries staff. Do you recall whether this document, with the exceptions I have mentioned, was provided to you by National Industries?

A. I don't honestly recall whether they provided it or whether we prepared it, but I will take your word for it that it was prepared by National Industries.

Q. Did you make reference to that document in the course of arriving at the proposal for the October 9 meeting?

A. Yes, I am sure we used it along with our own experience and judgment on the value of warrants.

Q. Do you know who prepared the last column, which I have just referred to?

A. No.

Q. Do you know whether this was prepared by Hemphill-Noyes as opposed to National Industries?

A. No, I honestly don't.

Q. Now, I will show you a document which has previously been marked as Exhibit No. 357, which is a letter from Hornblower and Weeks-Hemphill, Noyes over your signature, addressed to Mr. Yarmuth at National Industries, and dated October 31, 1969.

Do you recall writing that letter, Mr. Noyes?

[224] A. I signed it, so I obviously wrote it.

Q. Now, the first paragraph of this letter contains the following sentence: "We further understand that you desire our determination as of October 9, 196." [1969] That relates to the Hemphill determination of the value of the warrants to be issued to TSC shareholders, is that right?

A. Yes.

Q. What is the significance of the October 9 date in that sentence?

A. It was the date on which we had our meeting with National Industries to discuss an acceptable offering formula for TSC securities.

Q. Now the third paragraph of the October 31 letter reads as follows: "After studying price relationship of other warrants traded publicly, referring to customary systems of warrant evaluation, and considering the particulars of the proposed acquisition, we concluded that the warrants in question had a value of approximately $3.50."

Did I read that correctly?

A. Yes.

Q. Now, was that the value which you placed on [225] National warrants in arriving at the proposal which you made at the October 9 meeting?

A. That was one of the two values we placed on it. The other value was the market price.

Q. What was the market price of the National warrants at that time, if you recall?

A. I don't recall, but I see from those notes that it apparently was 5⅜th's on October 8.

Q. You are referring now to Exhibit 377-A, are you not?

A. Yes.

Q. Now, Mr. Noyes, what factors led you and your partners or associates to conclude that the National common stock warrants proposed for issue to the TSC stockholders had a value of approximately $3.50 per warrant at a time when the market price for the then existing and outstanding warrants of National was 5⅜th's?

A. To be fair in my answer, the public was appraising the warrants at 5⅜'s. We, internally, for our own consideration and for purposes of negotiating with National Industries management, concluded that on an empirical basis one could argue that

they were only worth 3½. On the other hand, Mr. Block, [226] we never ignore, in my business, what the public says a security is worth.

Q. In arriving at the value of $3.50 as shown in your letter of October 31, did you consider those factors which are stated in that letter?

A. I am sure we did.

Q. And this letter was written with respect to the proposal which was ultimately offered to the TSC shareholders in the proxy statement of November 12, 1969, was it not?

A. Yes.

Q. Now, one of the factors you indicate here is the fact that approximately 2.6 million additional warrants would be issued in connection with this acquisition, correct?

A. Yes.

Q. How did that fact affect your appraisal of the value of the warrants which would be issued in connection with the acquisition?

A. Well, it was—it represented a sizable additional supply of warrants in the market place.

Q. Those 2.6 million additional warrants were not outstanding and issued and tradeable on October 9, then, is that correct?

A. That is correct.

[227] Q. Your letter also makes reference to your having studied price relationships of other warrants traded publicly, correct?

A. Yes.

Q. Can you tell me which other warrants were studied.

A. Well, certainly those other—on Exhibit 388. There may have been others specifically and, of course, we are dealing in securities all the time and we have a background of understanding and knowledge of the evaluation of warrants.

Q. Other than those warrants which are listed on Exhibit 388, do you recall any other warrants as to which you studied price relationships in connection with your evaluation of the National proposal?

A. Not specifically.

Q. You also make reference in your October 31 letter of customary systems of warrant evaluations. What systems were those?

A. Well, once again, you are testing my memory as of two years ago. But one of the relationships that we have found between warrants and price for the underlying common stock is something in the area of 40 per cent; 35 to 40 per cent. In other words, [228] the warrant is liable to sell for something in the area of 35, 40 or 50 per cent of the market price of the common stock.

Mr. Block: Off the record.

(Discussion off the record.)

By Mr. Block:

Q. Now, you said, I believe, that was a relationship which you had found? Was that on the basis of research done by you or your associates?

A. That was our experience.

Q. Are you referring to your general experience?

A. Yes.

Q. I show you a document which has been marked as Exhibit 389-A through -F, which is entitled, "Memorandum to CFD Files," that is 11/25/69 from C. Michael Booth in re: Evaluation of the fairness of the National Industries' offer to TSC Industries.

Do you recognize Exhibit 389, Mr. Noyes?

A. Not offhand. Bearing in mind that this was apparently written by an associate of mine who was perhaps 27 years of age, I think it states reasonably our point of view at the time.

Q. Well, have you seen this memorandum before this time, sir?

[229] A. I don't honestly remember.

Q. Do you recall whether you asked Mr. Booth to prepare such a memorandum?

A. I don't even remember that, although it is normal for somebody, an associate concluding a file to write a memorandum of that nature.

Q. Now referring to Exhibit Roman Numeral III, which is on page 389-E of this exhibit, the heading is "Computing the Value of the NII Warrants as of 10/6/69." This page shows a computation under the heading "Item I, Rule of Thumb." This computation reflects a value for the NII warrants of $2.67 each, is that right?

A. Yes.

Q. Now, Item II on that page refers to a "IBA Study," with the parenthetical note, "Our interpolation may be subject to question," and it concludes with a price of $3.42 per warrant, is that correct?

A. Yes.

Q. Mr. Noyes, are you familiar with the IBA study which is referred to in that computation or notation?

A. No. I suspect that I read it or scanned it [230] years ago, but I am no longer familiar with it.

Q. Does IBA refer to the Investment Bankers Association?

A. I am sure it does.

Q. And is a copy of that study available at your office in New York?

A. I don't know. If you would like, I will be happy to try to find it.

Q. Well, it would be helpful if you could make that effort, and if you do find it, transfer a copy to Mr. Hamman so that he can advice [advise] me that he has it.

Mr. Block: Would that be agreeable, Mr. Hamman?

Mr. Hamman: Sure.

By Mr. Block:

Q. Now, the last paragraph on page 389-E in the last sentence states: "We concluded that the value of $3.50 was appropriate for the warrants."

And the sentence preceding that says, "The attached comparison tends to support this general rule. With the common price of $9 and ⅝th's warrants had a residual value between $3.39 and $3.85."

Did I read those sentences correctly, sir?

A. Yes.

[231] Q. Now the attached comparison which is referred is Page 389-F, is it not?

A. Yes.

Q. And that attachment is the document entitled, "Comparison of AMEX warrants" which we had previously marked as Exhibit 388 except that the final column is handwritten and there are two small computations at the bottom, is that right?

A. Yes.

Q. Mr. Noyes, were the type of warrants which are referred to as CD warrants, that is, warrants under which the party exercising the warrants may purchase the share subject to the warrant either with cash or with a related debenture—

Mr. Rothschild: I object to this line of inquiry as not related to any of the issues in this case.

By Mr. Block:

Q. Subject to that objection, sir, can you tell me if you are familiar with such warrants?

A. Yes.

Q. Were you familiar with such warrants at the time of your evaluation of the National Industries' proposal for the TSC Industries shares?

[232] A. Yes, I knew of their existence.

Q. For my own education, what does CD stand for?

A. Well, CD stands for the phrase "Cash or Debt" in the form that I used, and I believe generally.

Q. Now, do you know, Mr. Noyes, whether any of the warrants referred to on Exhibit 389-F are CD warrants?

A. No, I do not.

Q. Did you know at the time that you made your evaluation of the National Industries proposal?

A. I don't remember considering that.

Mr. Block: Let's take a five-minute break.

(Brief recess.)

By Mr. Block:

Q. Now, is the concluding statement on Page 389-F an accurate statement of the basis of your conclusion?

Mr. Hamman: Do you mean "E"?

Mr. Block: Excuse me. I do mean "E."

By Mr. Block:

Q. Is the concluding statement on that page an accurate statement of the basis for the conclusion [233] which you and your associates and partners reached, that a value of $3.50 was appropriate for the warrants to be issued by National to TSC shareholders?

Mr. Rothschild: I am going to object to that question. In the first place, the memorandum is dated the 21st day of October and I think this witness has already testified as to the conclusion having been reached somewhat earlier. I don't see anything except that the coincidence of the figures is there. Anyway, you can ask him the question in that form.

Mr. Hamman: This last statement states a conclusion. The way you ask the question he is going to be picking up other items, so I would ask you to rephrase the question. Could you rephrase it, and you can get what you want?

By Mr. Block:

Q. Perhaps I can make that question more clear by approaching it in part or separate questions.

The first computation on Page 389-E reflects a value of $2.67 for a warrant, is that correct, Mr. Noyes?

[234] A. Yes.

Q. The second reference is to the IBA study and indicates a warrant price of $3.42 per warrant, is that correct?

A. Yes.

Q. The last paragraph on that page—

Mr. Rothschild: I am going to object to that. It doesn't indicate anything as to price. It is value, it seems to me. Your reference to price is percentage of the exercise price.

By Mr. Block:

Q. Well, the $3.42 is a value conclusion on the basis of the second item there, is it not?

A. Yes.

Q. Now, the third paragraph on the same page concludes a value of $3.50 is—that is appropriate for the warrants, correct?

A. That was our conclusion based on empirical studies, although, you must bear in mind that the warrant was trading actively at approximately 5½ on the American Stock Exchange.

Q. Well, what is your conclusion with respect to a $3.50 value made on the basis of this statement [235] contained in the last paragraph on Page 389-E?

Mr. Rothschild: I object to that. You are now cross-examining. In the second place, the statement on the face of it is made after the fact of the valuation.

Mr. Block: When I say it is made on the basis of that statement, I mean made on the basis of the content of that statement, obviously.

Mr. Hamman: You mean solely?

Mr. Block: I will rephrase that in a further effort, here.

By Mr. Block:

Q. I am trying to understand the basis at which you arrived at a $3.50 value.

Mr. Rothschild: Why don't you ask him that.

By Mr. Block:

Q. I would like to know whether the basis you arrived at that value included the information contained in the third paragraph on Page 389-E.

A. Yes, it did include that. I think you should bear in mind that this part of our analysis was done in a large part for the purposes of [236] negotiating with National Industries' management.

As I said earlier, we have found it inadvisable in the securities business to argue with the market evaluation. We never ignore it, anyway. But for purposes of negotiating with National Industries' management, we use an intrinsic value of 3½.

Q. Well, you reached agreement with National at your meeting of October 9, 1969 with respect to the proposal that appears in the proxy statement, correct?

A. Yes, we did.

Q. And you wrote your letter to Mr. Yarmuth, which is Exhibit 357 on October 31, 1969, expressing a value for the warrants of approximately $3.50, is that correct?

A. Yes, we wrote that letter at his request.

Q. Did he tell you why he wanted you to write him that letter?

A. I have forgotten. I suspect I asked him, but I have forgotten.

Q. And as Mr. Rothschild pointed out, the memorandum which has been marked as Exhibit 389 was [237] dated November 25, 1969, and the page E is dated October 2, 1969, correct?

A. Yes.

Q. Now, in the course of determining your evaluation of the National Industries warrants, did you or your associates or partners make any effort to determine the value or evaluate the National Industries common stock?

A. Yes.

Q. What did you do in that connection?

A. You are going back two years, specifically, it is very hard for me to recall.

Q. Do you find anything in the documents which we have marked from your files, or in any other documents from your files, which refreshes your recollection?

A. You have shown me nothing here today.

Q. Would you like to just take a moment to look through these materials?

A. I see nothing there.

Q. Well, there are references in these materials to the market price of the National common stock at this time, correct?

A. Yes.

Q. And the last paragraph on Page 389-E in [238] referring to a value of $3.50 makes reference to a general relationship between price of the common stock associated with particular warrants, is that right?

A. Yes.

Q. Similarly, the computations under Item 1 and Item 2 on Page 389-E also relate to the market price of the associated common stock, do they not?

A. Yes.

Q. And your notes, which have been marked as Exhibit 374, in referring to the proposal which you recommended, reflects a warrant value of $3.50 per warrant, is that right?

A. Yes. They, of course, also reflect the market price of the warrant; 5⅜, roughly.

Q. Now, Mr. Noyes, you attended the meeting of the board of directors of TSC Industries on October 16, 1969 at which this transaction was discussed, did you not?

A. Yes, I did.

Q. And did you at that time relate to the individuals present your evaluation of the National warrants proposed to be issued under that transaction?

A. I don't remember. I think properly you [239] should remember that you should remember that Exhibit 374 is in my handwriting here with notes that I used in negotiating with National Industries management.

Q. You used those notes at the October 9 meeting, if I understand correctly?

A. I believe so. I am quite sure so.

Q. And that meeting followed a series of meetings between you and your partners or associates at which you considered the proposed transaction as proposed by National and as you were evaluating it, is that right?

A. Yes.

Q. And is the proposal which you made to National Industries and which appears in the November 12, 1969 proxy statement the consensus of the opinion of you and your partners and associates as arrived at at that time as to what would be a fair transaction?

A. Yes.

Mr. Rothschild: Off the record.

(Discussion off the record.)

Mr. Rothschild: Do you intend to indicate on the record Mr. Noyes' comment [240] that Exhibit 389-C contains an error in computation in the Hornblower and Weeks' value of 1½ warrants and 3½ as $4.50 whereas it should be $5.25, which would result in a total of $13.25 for shares of TSC common and premium of a market of 14 per cent instead of 8 per cent? It seems to me that correction ought to be made, since it was called to your attention. I can do it by cross examination.

Mr. Block: I would say you have already made it.

Mr. Rothschild: I haven't made it. I can't testify. The witness has to make it.

Mr. Block: Mr. Noyes, would you like to correct the computation?

Mr. Rothschild: I want him to correct it in the record.

Mr. Block: Is your question whether I will object to his making a notation showing the error in computation on this exhibit?

Mr. Rothschild: I simply want the record correct. If the exhibit is incorrect, I don't think you correct the exhibit. I think you [241] have the witness testify that the exhibit is incorrect and the manner in which it is incorrect. It is a simple

thing. It is arithmetic. The witness called it to your attention and you promptly moved to something else.

By Mr. Block:

Q. Well, Mr. Noyes, I have not done the arithmetic that Mr. Rothschild has done and I don't know if you have, but do you recognize an error in the second computation on Page 389-C?

A. I see an apparent error in arithmetic there. 1½ warrants at 3½ would result in an extension of 4¼, $5.25, and a total for the computation of $13.25.

I also note another difference between that and my personal notes. My personal notes assume a price for TSC common of 10¾, whereas, this tight computation assumes a price for TSC common of 11⅝. I can only suspect that the 11⅝ was after the rumor of the tender offer had gotten out.

Q. The price with respect to TSC common that you refer to from Exhibit 374 was 10¾, correct?

A. Yes.

[242] Q. Do you know as of what date that price was quoted?

A. Not specifically, although a board of newspapers could tell us. It is easily ascertainable, but I suspect 10¾ was the price on the first or second of October.

Q. It appears from the document you have looked at that the TSC common price of 11⅝ was a price quoted on October 6, is that correct?

Mr. Rothschild: The exhibit so states, Mr. Block.

By the Witness:

A. Yes.

By Mr Block:

Q. Now, Exhibit 389 on Page C makes reference to a TSC preferred stock quoted price of $11 per share, is that right?

A. It does, and I note that on September 30, the preferred closed at 10¾.

Q. Your notes on Exhibit 374, however, refer to the TSC preferred shares at $11 per share market, is that right?

A. In one place, but they are undated. I was working against an $11 price for the preferred.

[243] Q. Do I understand from your having reviewed your computations that in your notes of Exhibit 374 that you have ascertained that you were using a price for the TSC preferred of $11 per share?

A. Yes.

Q. Can you tell me, Mr. Noyes, what conclusion you and your partners or associates reached with respect to the evaluation of the National's Series B Preferred stock that was proposed to be issued to the TSC shareholders under the proposal that appeared in the proxy statement?

A. We reached the conclusion that it was worth in the area of its then market value, which was approximately 16½. I believe that on our calculations we rounded that off to 16.

Q. In the course of arriving at that conclusion, did you and your partners or associates consider the coverage of the preferred dividend by National that would result from the issuance of the additional preferred pursuant to the transaction?

A. We considered the capital structure of National, yes. Earnings.

Q. Is preferred dividend coverage a common factor considered in the evaluation of preferred shares?

[244] A. Yes.

Q. What did you determine as to the indicated preferred dividend coverage?

A. We reached the conclusion that National Industries was capable of covering the preferred dividend and paying it.

Q. Did you compare the indicated National preferred dividend coverage after the transaction with the preferred dividend coverages of other companies having preferred shares outstanding?

A. I don't honestly remember.

Q. In the course of your evaluation of these proposed preferred shares to be issued by National, did you consider the indicated yield on the basis of dividends?

A. Yes.

Q. And I think you testified earlier that you found the yield would be approximately 7.8 per cent?

A. Yes.

Q. Did you consider that to be a proper yield or fair yield for the preferred shares?

A. We considered it to be a relatively high yield for a convertible preferred share.

Q. And in arriving at that conclusion, did you [245] compare the indicated yield with the dividend yield of other preferred shares issued and outstanding and publicly traded?

A. From our experience—

Mr. Rothschild: I assume that that question included the word "convertible," although you did not say so, because there is quite a difference in the market between preferred and convertibles. I assume the witness' answer is on that basis.

The Witness: That is correct.

By Mr. Block:

Q. And your conclusion as to the yield with respect to these proposed preferred shares was based on the general experience of your firm, is that right?

A. Yes. I would rather say on the general knowledge and experience of the partners involved in making the decision.

Q. And do you recall whether you or your partners or associates made any specific comparison or references to other convertible preferred outstanding publicly traded at that time?

A. Specifically, I do not recall.

[246] Q. What is your best recollection as to that?

A. I just don't remember.

Q. Do you see anything in your files or the documents which we have marked from your files which refreshes your recollection as to that matter?

A. No, I do not.

Q. Now, in arriving at the Hemphill-Noyes evaluation of the National Series B Preferreds which were to be issued under this transaction, did you take account of the fact that the number of issued and outstanding Series B Preferreds would be increased as a result of this transaction?

A. Yes, we recognized the fact that there were a modest number of these preferred shares publicly held and traded in advance of this exchange offer.

Q. The information reflected on page 13 of the proxy statement shows that before the transaction National had 182,000 Series B Preferred shares outstanding and that there would be issued to shareholders other than National an additional 975,000 such shares as a result of this transaction, is that right?

A. Yes.

Q. Did that fact have any bearing on your [247] evaluation of the Series B Preferred?

Mr. Rothschild: You asked that and he answered it about two minutes ago.

By the Witness:

A. We considered it, but it was our opinion that the dividend yield would support a market value after the issuance of the additional B Preferred shares of roughly the previous market.

By Mr. Block:

Q. Now with reference to your letter of opinion of October 16, 1969, which has been marked as Exhibit 85, Mr. Noyes, the second paragraph indicates that in arriving at your opinion you and your associates and partners considered, among other things, the high redemption price of the National Industries B Convertible Preferred, is that right?

A. Yes.

Q. In what way did that redemption price affect your opinion?

A. It affected our opinion in that National Industries would have to pay the holders of that B Preferred a high price in order to get it out of their capital structure, in order to call it.

[248] Q. Do you recall what the redemption price was?

A. Not for sure, but I think it was something like $26 a share.

Q. And did you, in connection with that consideration, make specific reference to the redemption price under any other convertible preferred shares then issued, outstanding and publicly traded?

A. Oh, I don't honestly remember.

Q. Exhibit 85, which is your letter of opinion of October 16, also indicates that you and your partners and associates considered the substantial premium over current market values represented by the securities being offered to the TSC shareholders, is that right?

A. Yes.

Q. And what did you mean by substantial premium in that opinion?

A. There I believe we were referring to the total market value of the securities offered for each of the common and/or preferred shares of TSC Industries.

Q. From your documents, can you point out the value which you were referring to with respect to [249] the common and with respect to the preferred of TSC Industries?

A. From my notes the market value of the securities offered for each common share totalled 15⅞th's.

Q. That is, if I understand you, the market value of the package of National Securities comprising one-half share of National Series B Preferred and one and one-half National common stock was?

A. Yes.

Q. And what value were you referring to in that opinion as relates to the TSC Preferred shares?

A. Fourteen eight-five.

Q. Is that $14.85?

A. Yes.

Q. And does that relate to the package of National Securities consisting of 6/10th's of a share of National Series B Preferred and one National common stock warrant?

A. Yes.

Q. And those are the securities that were proposed to be issued to the TSC Industries pursuant to the proposal contained in the proxy statement, is that right?

A. Yes.

[250] Q. And does the phrase "Substantial premium over current market values represented by the securities being offered to TSC shareholders" as contained in your opinion of October 16 refer to anything other than the values which you have just mentioned?

A. No.

Q. Now, in arriving at your opinion as reflected and expressed in the letter of October 16, 1969, did you take account of the transaction whereby National Industries purchased shares of TSC Industries owned by Orville Peterson or members of his family?

Mr. Rothschild: I object to that. That specific question was asked in the previous deposition.

By the Witness:

A. I don't honestly remember. I am not sure that we knew on October 9 that National was going to buy the Peterson stock in a manner different from that being offered to the public, but I am not sure. Maybe in amplification of that I should say we did some figure work somewhere along the line and I don't know whether it was before or after October 9 and reached a conclusion that the offer [251] to the Petersons was worth something less than $31 a share after discounting the notes at 9 per cent, the notes that they received.

By Mr. Block:

Q. I would like to show you now a document which has been marked as Exhibit 390, consisting of three pages of handwritten notes entitled "The Peterson Purchase." Do you recognize Exhibit 390, Mr. Noyes?

A. Not specifically, although it does appear to be in Mr. Booth's handwriting.

Q. Well, does Exhibit 390 refresh your recollection as to your conclusions concerning the relationship, if any, between the Peterson transaction and the proposal which is contained in the November 12, 1969 proxy statement?

Mr. Rothschild: I again object to this. It is gone into at great length in the deposition as taken a year and a half ago, and this witness' memory was a year and a half fresher and it it very unfair to examine him again on the exact same subject matter. Some of the questions are identical with the questions asked before.

[252] Mr. Hamman: Go ahead and answer, but I am not going to let him go very far on this.

By the Witness:

A. The exhibit does corroborate my shaky memory as to the evaluation we came up with on the package offered the Petersons, and a couple dates would indicate the evaluation was made after October 9 and not before.

By Mr. Block:

Q Is Exhibit 390 the figure work that you were referring to that was done in connection with the Peterson transaction, Mr. Noyes?

A. It would appear so.

Q. Do you find any other documents in your files which either had been marked or not marked today that relate to the Peterson purchase?

A. I have no files. Either you or Mr. Hamman has them all.

Q. Those which are here on the table?

A. I haven't searched for them. I assume you have.

Q. Now, the notes issued to the Petersons were 5 per cent notes of National Industries [253] payable in six annual installments beginning on January 2, 1970 as stated on page 6 of the proxy statement, is that right?

A. Yes. Apparently.

Q. And do I understand that in arriving in yours or Hemphill-Noyes' evaluation—

A. May I correct you, please. The name of my firm is Hornblower & Weeks-Hemphill-Noyes. Colloquially it may be referred to as Hornblower-Weeks.

Q. Thank you. I will try to remember to use it.

Do I understand that the Hornblower evaluation of the Peterson notes was made on the basis of a 9 per cent discount?

A. Yes. Perhaps more accurately, the value of the notes was computed as if they were to yield 9 per cent to the holder.

Q. And in arriving at the Hornblower evaluation of the National Series B Preferred which was to be issued pursuant to the transaction contained in the proxy statement, did you consider the convertible feature of the Series B Preferred that was to be issued?

A. Yes, we did.

Q. How did the convertible feature of that [254] preferred affect your opinion as to the value of that preferred?

A. Well, it enhanced the value of the preferred as opposed to if the preferred had not been convertible.

Q. Did you make any determination as to what the value would be if it did not have a convertible feature?

A. I don't think we did. It wasn't germane. We weren't being faced with that.

Q. Well, is it correct that the Hornblower value for the National Series B Preferred to be issued of approximately $16 per share included whatever value you placed on the convertible feature of those shares?

A. Yes.

Q. Mr. Noyes, in your opinion, is there any inconsistency between valuing the Peterson 5 per cent notes on a 9 per cent yield basis while at the same time valuing the National preferred shares Series B to be issued in this transaction on the basis of a yield of 7.8 per cent?

Mr. Rothschild: Object to that question. One is a debt and the other is a security with a convertible privilege into equity. [255] You are comparing apples with oranges.

Mr. Hamman: Answer it, if you can.

By the Witness:

A. We do not feel it was inconsistent, and I still do not, in light of the conversion feature of the B Preferred and the high call price.

By Mr. Block:

Q. Now, in arriving at the Hornblower opinion with respect to the package of National securities to be offered with respect to TSC Industries pursuant to the proxy statement proposal, did you take account of the fact that the transaction as proposed was in a form which would be result in the recognition of taxable gain or loss to the shareholders of TSC Industries?

A. Yes, that was one of the considerations.

Q. What considerations were given by you and your associates or partners to that factor?

A. Well, it was a consideration, but inasmuch as the shareholders to whom we felt prime responsibility, who had bought the stock on the offering, had bought it at a price higher than the market value of the securites being offered them on this exchange offer, it would not have resulted in a taxable [256] transaction.

Mr. Rothschild: You mean it would have resulted in a loss?

The Witness: Yes.

Mr. Rothschild: For tax purposes?

The Witness: Yes.

By Mr. Block:

Q. Which shareholders of TSC are you referring to?

A. The ones who bought the shares at the time of the public offering which we managed in March of 1969.

Q. Did you make any inquiry of National Industries as to the reason why the transaction was proposed in that form, that is, a form taxable to the shareholders of TSC?

A. Along the line I know we did. It is my understanding that this resulted in a tax advantage to National Industries. And just parenthetically, it resulted in a tax advantage to those shareholders to whom we felt primary responsibility.

Q. Those that you are referring to being the shareholders who purchased on the March 18, 1969 public offering, is that right?

A. Yes.

[257] Q. Mr. Noyes, in the course of the determination of the Hornblower opinion as to the fairness of the National-TSC transaction as expressed in the October 16 letter of 1969, did you or your associates or partners consider any factors other than those stated in the letter and those which you have testified about so far?

A. Oh, I am sure we did.

Q. What other factors did you consider?

A. Why, Mr. Block, it is two years later and there is no chance of my being completely accurate in answer to your question. But one of the things that we very seriously considered was the status of management of TSC as of the fall of 1969.

Q. What was the status of management of TSC as of the fall of '69 which you considered?

A. The fact that the chairman of the TSC Industries had resigned, Gardner Abbott. I believe he had resigned by then and that the president of TSC Industries, Mr. Shaffer, [Schaeffer] Richard Shaffer, [Schaeffer] had indicated that he was seriously considering an employment from another company.

Q. Now, had he accepted that offer?

A. There really was no one in the TSC organization [258] in our opinon who was capable of running the company. I believe also, by the fall of '69—yes, I know in September of '69 Mr. Sam Sharfman had resigned from management of the Community Discount Centers Division.

I know another factor that we seriously considered was the trend in earnings of the Community Discount Centers that had become apparent by late September in '69, the downward trend in earnings. We further considered the fact that National Industries was a rather broadly diversified company drawing its earnings from a number of different industries whereas TSC was entirely dependent for its earnings on the merchandising industry.

Q. Did you consider any other factors?

A. We undoubtedly did, but I don't remember which one.

Q. Mr. Noyes, you referred, I believe, to a downward trend in the earnings of the Community Discount Division.

A. Yes.

Q. What were the earnings of the Community Discount Division which indicated that trend?

A. I don't remember the numbers.

Q. You are a member of the TSC executive committee, [259] is that right?

A. Yes.

Q. And you therefore receive copies of the various agenda that were forwarded for meetings of the executive committee and for the board of directors, is that right?

A. Yes.

Q. Now I will show you a document which has been marked as Exhibit 391, which is a four-page typed document entitled "Agenda For Executive Committee Meeting," which was in your file. Is that one of the agenda which you received for executive committee meetings of TSC Industries?

A. I would assume so. It has my handwriting on it.

Q. Now, this agenda in Item 11 contains the item; "Discussed discount store division," and there follows a set of figures comparing what is referred to as pretax profits for the nine months ended July 31, 1969, and the same period for 1968, correct?

A. Yes.

Q. I will also show you a document which has previously been marked as Exhibit 363 and is entitled, "Agenda For Board of Directors Meeting," [260] carrying a date of September 15, 1969, and I refer you specifically to Item 8 of that document which contains the same comparative summary of pretax profits in Item 8 as is reflected in Item 11 of Exhibit 391.

A. True.

Q. Now, do either or both of these exhibits, 363 and 391 refresh your recollection as to the earnings of the Community Division?

A. Yes, they corroborate it.

Q. Can you recall the approximate date that you received Exhibit 391?

A. No.

Q. Do you recall whether it related to the same meeting as the agenda which is dated September 15, 1969?

A. I assume it related to the executive committee meeting that preceded the directors meeting.

Q. Well, does the comparative summary of pretax profits contained in those two exhibits identify the downward trend that you are referring to with respect to Community Division earnings?

A. Yes.

Q. I will also show you a document which is [261] the interim report to the stockholders of TSC Industries for the quarter ending July 31, 1969 and previously marked as Exhibit No. 60. Were you aware of the results of TSC Industries and its subsidiaries as reflected in this quarterly report at the time

that you and your associates or partners made your determination as to the fairness of the National-TSC proposal?

Mr. Rothschild: Do you have any doubt as to that?

Mr. Block: Not really.

By the Witness:

A. I am not sure whether we had received this.

Does it differ markedly from the figures which I did have as included in the executive committee minutes?

By Mr. Block:

Q. You are referring to the material that has been marked as Exhibit 391 and which you did have prior to your receipt of your quarterly report to stockholders as Exhibit 60, is that right?

A. Yes.

Q. And did you find on Exhibit 391 that the figures therein differed markedly from Exhibit 60?

[262] A. On a cursory examination, it wouldn't appear so. Other than the fact that Exhibit 60 shows the result for the three months ending July 31 as well as the results for the nine-months ended July 31.

Q. Mr. Noyes, during the time that the Hornblower firm determined its opinion as to the fairness of the proposal which appears in the proxy statement, you were a director of TSC Industries?

A. Yes.

Q. At that time did you know personally, or were you familiar with in any way a gentleman by the name of Edward Merkle?

Mr. Rothschild: I am going to object to this whole line of inquiry. I trust it will not be necessary for me to object to every question. This witness' testimony on anything relating to Mr. Merkle can't have any bearing on any issue in this case.

Mr. Hamman: Go ahead.

By the Witness:

A. I didn't know him. I may have met him somewhere along the line, but I did not know him and I don't know right now what firm he is or was [263] associated with.

By Mr. Block:

Q. One firm or entity with which he was associated was an investment fund known as Madison Fund, Inc. Were you familiar with Madison Fund at that time?

A. I know the name and I knew it then, but I was myself not acquainted with the management of Madison Fund nor had I personally ever had any dealings with them that I can remember covering. Twenty-three years is a broad sweep, there, but—

Q. Well, I am specifically interested in the period during which you were a director of TSC Industries.

A. I remember of no dealing with Mr. Merkle during that period or any other period.

Q. And at the time that you and your partners or associates arrived at the Hornblower opinion concerning the proposed transaction between National and TSC Industries, were you aware that Mr. Merkle was receiving payments from National Industries?

A. Not that I can remember.

Q. And were any of you aware at that time that during the period from March of 1968 and continuing up to and after October 14, 1969 that the Madison [264] Fund was making a series of purchases of National common stock in the market?

Mr. Rothschild: I object to that as a misstatement of the record, when you say "up to and after." You know that is not the fact insofar as relates to this transaction. There were no purchases after October 14 until a month after this transaction was closed, specifically, December 29. That is a misstatement of the record. You have got it right in front of you.

Mr. Block: I didn't intend to misstate the record.

Mr. Rothschild: It is a fairly significant statement that purchases were continuing up to and after October 14. That is a very critical date. I don't know how you expect this witness to sort out—well, I object to the whole inquiry.

Mr. Hamman: Is there a question pending?

Mr. Block: I can't remember.

(Record read by the reporter.)

By the Witness:

A. No, I was not aware of it.

[265] By Mr. Block:

Q. In order to be sure that I do not in any way mislead you in my previous question, Mr. Noyes, I am going to mark as Exhibit 392 a 7-page summary entitled "Madison Fund, Inc., National Industries," which was supplied to me by Mr. Rothschild in connection with a request for information and identified as being purchases made by Madison Fund, Inc. of National Industries common stock and of National Industries 5¾ per cent convertible subordinated debentures, and ask you, please, to look through those computations. You might pay attention to the dates as of which those transactions occurred.

A. Yes.

Q. Those are the purchases to which I was referring in my earlier question, so I will now ask you again to be sure that they are clear.

Did you, or as far as you know, any of your associates or partners know of those purchases or of any purchases being made by Madison Fund, Inc. of National common stock at the time that you determined the Hornblower opinion as to the fairness of the National-TSC transaction?

A. I was unaware of them and I do not believe [266] that my partners in corporate finance who considered this matter were aware of them.

Q. Now, Mr. Noyes, are you familiar with the transaction in October of 1969 whereby 40,000 shares of TSC convertible

preferred stock was issued to the Sandvig Family, the former shareholders of SAS, Inc.?

A. Today I am not closely familiar with it. I would have to refresh my memory.

Q. I will show you a copy of a document previously marked as Exhibit No. 5 in this case, which is the minutes of the meeting of the board of directors of October 16, 1969, that is, the board of directors of TSC Industries, and direct your attention to the resolution appearing on page 15 of those opinions relating to that transaction. You were present at that meeting, were you not?

A. Yes.

* * * * *

[271] *Redirect Examination by Mr. Block.*

Q. Mr. Noyes, when you looked at Exhibit 392 which are the summary of purchases of National common stock made by the Madison Fund, did you attempt to determine the amount involved in those transactions?

A. The amount of dollars?

Mr. Rothschild: Excuse me. I am going to object to that. That has absolutely no relationship to the cross-examination. You terminated your questioning. I cross-examined him on two specific lines. You are not going back to Madison Fund. I think that is clearly improper.

Mr. Block: You asked him if anything came to his attention which would have changed his opinion, did you not?

Mr. Rothschild: He said no.

Mr. Block: I think I have a perfect [272] right to inquire further on this point.

Mr. Hamman: The question is, did he attempt to figure out the amount of dollars on that schedule.

By the Witness:

A. I did not attempt.

Mr. Block: So that we can have a clear answer to a clear question, would you read, please, my question, and then allow Mr. Noyes to state his answer.

(Record read by the reporter.)

By the Witness:

A. My answer was no. I just scanned this. If you wish to base—I haven't studied it.

By Mr. Block:

Q. And would it be pertinent to the Hornblower opinion as to the fairness of this transaction if there were substantial and continuing purchases of National securities in the market during the period shown on those summaries?

Mr. Rothschild: I am going to object to that. If you are asking him what those purchases might be, I might not object on the same ground. But I don't know what that [273] means. If you mean, would those purchases have made it, you should ask him. I will object to it on the grounds that it is not relevant, but the question you asked is unanswerable.

Mr. Block: Would you read my question?

(Question read by the reporter.)

Mr. Block: Let me rephrase that question.

By Mr. Block:

Q. Would it be pertinent to the Hornblower opinion as to the fairness of this transaction if there were substantial and continuing purchases of National securities in the market during the period beginning in March of 1968 and through October 14, 1969, which were made at the behest or under the control or at the request of National Industries?

Mr. Rothschild: I am going to object to that. In the first place, there is no evidence in the record that there were any purchases of substantial and continuing nature, whatever that means, made at the behest of National Industries, and unless [274] you define what you mean by substantial and continuing

in specific terms, it is entirely hypothetical. If you want to ask this witness if his opinion would have been different if he had known of these purchases, that I think is a proper form of question. I think it is improper on the grounds of relevance, but the rest is all hypothetical. You can't ask him a question like that. You have to define what you are asking him; otherwise, his answer can mean one thing to you and another thing to me.

Mr. Block: Can you answer the question as I asked it, Mr. Noyes?

Mr. Hamman: I think the objection is well put. Do you have something to show Mr. Noyes that there were purchases under the control of National? Then we will consider the question. But just asking for an opinion, out of the air, I won't permit him to answer.

By Mr. Block:

Q. Mr. Noyes, I take it you refuse to answer that question on the advice of your counsel?

[275] A. Yes.

Q. Mr. Noyes, the summary of transactions contained in Exhibit 392 indicate that during the period beginning March 22, 1968 through December 30, 1968 the Madison Fund purchased an aggregate of 97,818 National common shares in some 88 separate transactions on the dates indicated. The total amount of money committed to those transactions was approximately two million dollars. The summaries also show that for the period beginning March 5, 1969 through October 14, 1969 the Madison Fund purchased an additional 74,682 shares and that the amount of money committed during that period of time in those transactions was something just under another million dollars. The computation of dollars is not contained on this exhibit, and is an approximation of my own.

Now, if you had known about those purchases in October of 1969, would that have made any difference in the Hornblower opinion with respect to the fairness of this transaction?

Mr. Rothschild: I am going to object to that as entirely speculative in the absence of anything showing that these were [276] transactions made at the request of National. It is not relevant to any of the issues in this case.

The Witness: I can't answer that question off the cuff. It would require a good deal of study as to the total volume of the security, number of shares traded during these various periods of time.

By Mr. Block:

Q. If you had been given this information in October of 1969 during the course of the determination of the Hornblower opinion, would you have made further inquiry with respect to these transactions, or asked for further information?

Mr. Rothschild: I object to that as being entirely speculative and hypothetical.

By the Witness:

A. That is a pretty hypothetical question. I can't answer that in retrospect.

By Mr. Block:

Q. You just indicated you would have to give consideration to the information in order to answer my previous question, didn't you?

A. My earlier answer stands, yes. You would [277] have to look at it in relationship to the total volume on the exchange.

Q. I take it, then, that you would have made that kind of a review if you had had this information in October of 1969, isn't that right?

Mr. Rothschild: Object to that as cross-examination.

By the Witness:

A. We might have.

A. Tractor Supply Company was advertising in the Wall Street Journal for an assistant treasurer of about 40 years of age, if I remember correctly. I applied for this position and won it, and went on as assistant treasurer.

Q. How long were you assistant treasurer?

A. I was assistant treasurer until, I believe, March of '61.

Q. At that point what change occurred?

A. I became treasurer of the corporation.

[66] Q. And how long did you continue in that capacity?

A. I believe I had that title and position until February 19th of '68.

Q. What happened on February 19, 1968?

A. I became executive vice president of TSC Industries and became the chief executive officer of the Farm Store Division.

Q. When I asked what happened, I was hoping you would respond with a statement of how this TSC came into being.

A. We were talking about my career and positions and so I related to that.

Q. Was there a merger involved about that time?

A. Yes. On February 19th, Tractor Supply Company, which was listed on the New York Stock Exchange, and Community Discount Centers, which was listed on the American Stock Exchange, entered into a merger and merged into a new company known as TSC Industries.

Q. A Delaware corporation?

A. A Delaware corporation. I believe the word "merge" is correct, although I would not want to be specific there.

[67] Q. I think we have had a document identified here, which refers to it as a merger.

A. I think that is correct.

Mr. Stevens: Exhibit 53 for identification is plan an agreement of merger of Tractor Supply Company and Community Discount.

Mr. Block: I have no further questions.

Do you want to reserve for the signature? Is that the way you want to do it?

Mr. Hamman: I want signature on this.

Mr. Block: We will reserve until they have read the transcript before signing.

(And further deponent saith not.)

IN THE UNITED STATES DISTRICT COURT

Northern District of Illinois

Eastern Division

[Title omitted in printing.]

The deposition of RICHARD H. SCHAEFER called by the plaintiff herein, pursuant to agreement and pursuant to the Federal Rules of Civil Procedure, before Dolores Brennan, Certified Shorthand Reporter, a notary public in and for the County of Cook and State of Illinois, at Suite 2700, 125 West Madison Street, Chicago, Illinois, on Tuesday, December 23, 1969, at the hour of 2:00 o'clock p.m.

* * * * *

[65] A. Well, I was employed gainfully since about the age of twelve doing various tasks. I was a carpenter. I ran, at the age of probably 19 or 20, I ran a ready-mix concrete plant in Ohio for a period of three or four months. Then I had various and sundry jobs: worked in the fraternity house, things of that nature, over the years.

Q. As far as full-time employment, except for vacations or this concrete job, et cetera, you have given us in substance your major experience?

A. In substance, yes.

Q. What position did you have with Tractor Supply when you went to work there?

By Mr. Shure:

Q. Which created TSC Industries, Inc., is that right?

A. That is correct. TSC Industries, Inc. was created prior to that. That was the vehicle in which the Farm Store Division and Community ended up within.

Q. Continue with the statement of your various jobs with TSC Industries, Inc. In February, 1968, you became what?

A. Executive vice president of TSC Industries. Became the chief executive officer of the Farm Store Division, which was formerly known as the Tractor Supply Company.

Q. Who was the chief executive officer of the entire company?

A. Gardner Abbott, chairman of the board. On February 19th, that became his position.

[68] Q. Is the chairman of the board the chief executive officer?

A. According to the bylaws, it is my understanding the chairman of the board is the chief executive officer.

Q. How long did you continue in the capacities with which you assumed on February, 1968?

A. I continued in those capacities until March 31, 1969, when at the pleasure of the board of directors I was elected president of TSC Industries.

Q. When did you become a director of the company?

A. Which company?

Q. Of any company. Of any of those companies, Tractor Supply Corporation—

A. I became a member of the board of directors of Tractor Supply Company, I believe, in March of 1964.

Q. And continued how long?

A. I have been a director of Tractor Supply Company in the succeeding successor companies since.

Q. Right through the merger?

A. Yes.

• • • • •

[96] Q. Did he ask you to do any accounting services for him in connection with the agreement?

A. No.

Q. Did you meet Friedman, Koven or any member of that firm at that time?

A. No.

Q. Did you know they were in that particular deal at the time?

A. I may have known someone was in, and in looking back it was Friedman, Koven, but I don't recall having met any member of their firm prior to September of '69, although I could have. I had dinner with a group of people in New York, and I am sorry, if Mr. Salzman was there, I don't know. I don't remember.

Q. Did you discuss with Mr. Schmidt what was going to happen to your job "as heir apparent" or otherwise in the event the sale of his stock to National was consummated?

A. No. I wasn't concerned.

Q. But you were concerned about the transaction for some reason?

[97] A. I was concerned about carrying out my responsibilities as a corporate officer.

Q. And that is all?

A. Well, "that is all" sounds like, you know, there is only one thing I was concerned about. All the ramifications of this transaction I was concerned about. We have many employees. We had a business. We had shareholders. I had a responsibility of notification. Many responsibilities of seeing that in the event the transaction, such as the one took place, took place, things were orderly.

Q. Did you discuss these elements with Mr. Schmidt?

A. Why, I would have to—what element again? My—

Q. Your responsibilities.

A. My responsibilities, I counseled with myself and considered the things that I should do in the event the transaction took place.

• • • • •

[147] By Mr. Shure:

Q. Now, Mr. Schaefer, would you please turn to page 7 of Plaintiff's Exhibit 1 for identification, which is the proxy statement, and would you kindly read the first full sentence at the top of page 7 beginning with "The remaining directors" listing—

A. B-7? I don't have that in front of me.

Q. Page 7.

Mr. Stevens: I have a copy. I will give it to him.

By the Witness:

A. Now, Mr. Shure, you asked me to what, please?

By Mr. Shure:

Q. I ask you to please read the sentence beginning, "The remaining directors of TSC . . ." and ending ". . . are not affiliated with National."

[148] Do you see that?

A. I have.

Q. Now, the word "affiliated" appears in the next to the last line of that sentence. Do you see it?

A. Yes, sir.

Q. Do you know what it means?

A. I have my own definition of it, yes.

Q. What is your definition?

A. That we are not employed by National. That we are not under their direction.

Q. Go ahead.

A. I think that is it.

Q. Did you discuss the use of that word with anybody connected with the office of Friedman, Koven in connection with the preparation of this proxy statement that was issued by TSC Industries, Inc., for the December 5, 1969, special meeting of stockholders?

A. No. I felt I understood it.

Q. Who drafted that sentence, if you know?

A. I do not know.

• • • • •

[161] Q. Did you ever—strike that.

Who from Mr. Blancke Noyes' firm. Hemp Noyes—

Mr. Slovick: Hornblower & Weeks-Hemphill, Noyes.

By Mr. Shure:

Q. With whom from that firm did you discuss the appraisal which Mr. Noyes ultimately produced on behalf of his company with regard to the fairness of the terms?

A. Blancke Noyes.

Q. When did you first discuss it with him? At the time you received the letter?

A. I visited with Mr. Noyes in New York on this matter.

Q. On what day?

A. September 24th, probably.

Q. Was that the purpose of your trip to New York?

A. That was one of the purposes of my trip to New York.

Q. What else happened on that trip relating to TSC Industries, Inc. business?

[162] A. On that trip, pursuant to previous agreement, we discussed the cash flow statements of TSC Industries pursuant to direction by the Board of Directors, I believe.

Q. Discussed with them? With whom?

A. Mr. Noyes, Mr. Yarmuth and myself.

Q. Were you the only three present at this meeting in New York?

A. Yes, I believe so.

Q. And that was what date in September?

A. I can verify it. I believe it was September 24th.

Q. What else did you do in New York other than with Mr. Noyes in respect to TSC Industries, Inc.'s business on that trip, on the occasion of that trip on September 24th? What other business did you conduct in New York other than with Mr. Noyes on that trip?

A. I met with the Chairman of the Board of Uni-Shops.

Q. What is that?

A. That is a retail company. Relative to problems of our discount store division, and what they might do to help us.

Q. How much time did you spend with him?

[163] A. Three hours, maybe.

Q. How much time did you spend with Mr. Noyes on that trip?

A. Probably something around the same amount of time.

Q. And you said you were there to discuss the cash flow of the company with Mr. Noyes, pursuant to directions of the Board?

A. That is correct.

Q. Did that have anything to do with the proposed sale of assets in the conduct of the ordinary business of the corporation?

A. The cash flow?

Q. [sic] The cash flow discussions were directed prior to the knowledge of a proposal from National. In other words, the direction by the Board to undertake this discussion was given prior to knowledge of this transaction.

Q. How much time did you spend with Mr. Noyes on the cash flow questions, and how much time did you spend with him with regard to the proposed transaction for acquisition of the assets by National?

A. Oh, probably we spent three hours. We [164] probably discussed the proposed transaction for maybe an hour and a half or two hours, and the cash flow for an hour and a half or two hours, to the best of my knowledge.

Q. What documents did you carry with you for your discussion with Mr. Noyes with regard to the sale of assets, and what documents did Mr. Noyes have with him with respect to that discussion?

A. My recollection is that with regard to this transaction, I had no documents.

Q. How about Mr. Noyes, did he have any?

A. I don't think he had any documents with regard to this transaction, although I don't know.

Q. What was the subject matter of this discussion between you and Mr. Noyes with regard to—

A. Mr. Yarmuth was there, too, by the way.

Q. Did Mr. Yarmuth introduce the subject to Mr. Noyes, and tell him about what the proposal might be and just how was it handled?

A. Yes. Mr. Yarmuth introduced Mr. Noyes to the proposed transaction.

Q. Were they strangers or did they know each other.

A. They served on the same board since [165] March 31st.

Q. You are right.

When Mr. Yarmuth told Mr. Noyes about the transaction, did he explain why he was telling him about it, the proposal of a transaction?

A. I think that that sort of spoke for itself.

Q. And did he indicate what the purpose of the trip was?

A. The purpose of the trip was to discuss our cash flow statements as previously directed by the Board.

Q. The Board directed that the president and Chairman of the Board talk to Mr. Blancke Noyes about the cash flow?

A. No.

Q. What did the Board direct?

A. The Board directed that a committee be established, namely Mr. Schaefer, Mr. Yarmuth and Mr. Noyes, to review the cash requirements of the corporation, preparation of cash flow statements, et cetera, all related to cash.

Q. Well, when Mr. Yarmuth told Mr. Noyes about this proposal of the acquisition, did Mr. Noyes make any response?

[166] A. Yes. He asked questions, I believe.

Q. Do you think it was a good idea?

A. Well, if I were to portray the situation, I would say that it was something like the position I was in the first time. It was a matter of receiving facts, asking points of clarification, rather

than one of making a decision or commenting as to the question without further study.

Q. When did Noyes start his study? Did he start it then or did he start it a week or a few days before the 16th of October?

A. To my knowledge, he started it at this point.

Q. At the time of this meeting?

A. Yes, sir.

Q. Did Mr. Yarmuth spell out all the terms to him then orally or in writing?

Mr. Karon: I object to the form of the question. It is ambiguous. Are we still at the meeting of Noyes?

Mr. Shure: Yes, the meeting of Yarmuth, Noyes and him asking whether he spelled out the terms.

Mr. Karon: He meaning?

Mr. Shure: He, meaning Mr. Yarmuth.

Mr. Karon: All right.

* * * * *

[197] You continued as a trustee up to the date of the meeting of December 5, 1969, the special meeting of shareholders to vote on the sale of the assets to National?

A. Mr. Shure, I am not certain of the date at which I was elected as a trustee of the Tractor Supply Company Stock Bonus Trust Fund, therefore, I hesitate to answer you unequivocally that I was a trustee at the date of the merger between Tractor and Community.

Q. I am not talking about that merger. I am talking about the meeting of December 5, 1969, which was a special meeting of shareholders to vote on the sale of the assets of TSC Industries, Inc. to National. That is the recent meeting.

A. I was a trustee on December 5, 1969.

Q. And were you a trustee when the proxy statement was issued for that meeting?

A. Yes.

Q. Did you sign a proxy for the shares owned by that Fund?

A. Yes.

Q. Who else signed it?

A. When I received the proxy card it had been [198] signed by Mr. Schweik and Mr. DeForest.

Q. What did you do in connection with the signing of that card? Did you do anything other than sign it, or just sign it?

A. Do you mean at the very moment I signed it, did I do anything else?

Q. No. As a preliminary to the signing of it.

A. Well, I did many things prior to that time. Gave consideration to many things. The trustees discussed the transaction, taking in full account the responsibility they had to the company and the participants in the plan.

Q. When you speak of the trustee, you are speaking of Mr. DeForst [DeForest], Mr. Schweik, right?

A. I am.

Q. Did you discuss the transaction with respect to whether or not that proxy should be executed for the trust?

A. Each trustee decided how and what position he was going to take independent of the others. We discussed the entire transaction so that everyone had the opportunity to give full consideration to the proposed transaction.

Q. But that was a discussion independent of [199] the execution of the proxy, is that right?

A. Probably was a discussion pursuant to the execution of the proxy.

Q. After it was signed?

A. Prior.

Q. I do not understand what you mean by pursuant to the execution. That implies the discussion was after the execution.

A. If my selection of words was in error, I apologize.

We discussed this prior to the execution of the proxy.

Q. Did you discuss whether or not you should sign the proxy, is that right?

A. No. We discussed the transaction.

Q. You did that in your capacity as officers and directors, or whatever you were, of TSC Industries, Inc., is that right?

Mr. Stevens: I object to the form of the question including a conclusion of Mr. Shure of the capacity under which people were acting when they talked about things.

You can answer to the best of your knowledge.

[200] Mr. Shure: Withdraw that question.

By Mr. Shure:

Q. Did you ever, prior to the execution of this proxy, discuss with your fellow trustees, Mr. Schweik, Mr. DeForst [DeForest], whether that proxy should be executed?

A. I think that we discussed the transaction, and I did not give instructions to anyone as to what to do.

Q. What transaction are you talking about when you say, "we discussed the transactions"?

A. The proposal that was put forth in the proxy statement.

Q. I am not asking you about that.

The question I am asking goes directly to the question of whether you discussed with either one or both of the other two trustees the question of whether or not anyone or all of you should sign that proxy card, that specific proxy card.

Mr. Stevens: Before it was signed?

Mr. Shure: Before it was signed.

By the Witness:

A. I think we all acknowledged and discussed the fact that we had to take a position and sign [201] the proxy card, voting for or against the certain proposals that were enumerated.

By Mr. Shure:

Q. When and where did this discussion take place?

A. It took place in our offices at Ravenswood, Ravenswood Avenue.

Q. And when did it take place?

A. I would say it took place sometime prior to December 5th and subsequent to the mailing date of the proxy material.

Q. Who was present at that discussion?

A. Mr. DeForest, Mr. Schaefer and Mr. Schweik.

Q. Was anyone else present?

A. To my knowledge, there was no one present, to my recollection.

Q. Where did the discussion take place in the offices of the company, what room?

A. The discussion probably—or, could have taken place in Mr. Schweik's office, Mr. DeForest's or my office. I, frankly, I couldn't pinpoint a thing like that.

Q. Do you remember that such a discussion did take place between sometime in November and prior to [202] December 5th, or are you just guessing or assuming?

A. No. A discussion, in fact, took place relevant to that proxy.

Q. That specific proxy for the Fund, is that what you are saying?

A. That is what I am saying.

Q. Now, what did you say, what did Mr. DeForest and what did Mr. Schweik say during that discussion?

A. Well, I think I can tell you what I said.

I simply reviewed the situation, being the material that was in the proxy and the exhibits, indicated to my co-trustees that prior to the meeting that I would take my position and vote my third of the proxy or however technically you would put it.

Q. You would vote it.

How would you vote it?

A. I never told anyone until I voted.

Q. Well, when you and the other trustees met and discussed it, did you discuss the pros and cons of the pending proposal?

A. We did.

Q. And you say that you said you would vote. You wouldn't say how you would vote, is that it?

A. No. It was not my interest to influence [203] anyone on how to vote, nor was I concerned or really cared. They had their own duty to carry out. I did not inquire of them how they were going to vote. I do not recall that having been discussed.

Q. What was said by either of the others at that time?

A. I think the transaction was discussed. The welfare of the company, which in turn, would be the welfare of the employees and participants in the Fund. Gave futuristic considerations to the investment that the participants had in the Fund. Gave consideration to the future of the company with or without the transaction. Essentially, the entire discussion revolved around the benefits to the participants of the Fund as participants who held an equity position through this Fund in TSC Industries.

Q. These were employees of TSC Industries, were they?

A. Or its subsidiaries.

Q. How long did this discussion with Mr. DeForest and Mr. Schweik take?

A. I am unable to be specific, but I would say that we had several discussions on this point.

Q. On this particular proxy, about executing [204] this particular proxy card?

A. We had several discussions as trustees.

Q. Did they all take place in the office?

A. They all took place in our office location.

Q. Were these formal meetings of the trustees?

A. Yes, they were meetings held for that purpose, if that comes under the definition of formal.

Q. Who acted as secretary at those meetings?

A. I cannot recall whether we recorded the minutes of that meeting or not. If we did, Mr. Schweik would have acted as secretary.

Q. How much time did any one of these meetings take? You say there were several meetings. Pick one.

A. I presume that these meetings took 30 minutes, 40 minutes.

Q. You mean they all took about the same time, 30, 40 minutes?

A. I don't know. I don't know. I am unable to divide up my day into time periods.

Q. You stated what you said.

What did Mr. DeForest say?

A. I would prefer you ask Mr. DeForest, because I don't really recall. We talked about [205] this transaction at great length.

Q. How long prior to that had you been a trustee of that Fund, approximately, six months, a year, two years?

A. March 31, or sometime prior to that, I know Mr. Walker and Mr. Abbot resigned.

Q. As trustees, you mean?

A. As trustees. That Mr. Sullivan was a trustee. And at what point of time I became a trustee, I hesitate, I can't recall it. I just can't recall it.

Q. How many meetings prior to the several meetings you mentioned a few minutes ago of the trustees occurred during the period that you were trustee, and I am referring to meetings where you said, "We are now meeting as trustees"?

A. To my knowldge, until I became president of TSC Industries and the trustees consisted of Mr. Schaefer, Schweik and DeForest, there were no formal meetings of the trustees of the Tractor Supply Company Stock Bonus Trust Fund. However, since that time, we have had several formal meetings where we discussed different decisions that had to be made relative to our duties as trustees, and have kept minutes.

[206] But to my knowledge, there are no minutes prior to that period of time.

Q. Were these meetings where minutes were kept prior to December 5, 1969?

A. There are minutes prior to that time.

Q. I see. But, you I believe, said that you do not recall whether minutes were kept at any of the several meetings on the question whether to vote the proxy for or against the proposals to be considered on December 5, 1969?

A. I do not recall if there is a meeting in which the subject of how to vote the proxy—I am not certain that there

was any minutes kept of such a meeting or if the minutes were kept of that meeting, if the minutes reflect that the discussion was on how to vote. The discussions were broad in nature in an effort that we all felt certain we were informed of the transaction, and we discussed the implications that we each felt of the transaction. So that we would be in a position to vote the proxy when it was time to vote it.

Q. You spoke earlier of the discussion centering on a dealing with the benefits of the proposed dealings, is that a correct statement?

[207] A. Yes, I believe that is a correct statement.

Q. Did you discuss the demerits of the proposed deal, assuming there were any?

A. I think we looked into the future on the good and bad side.

Q. What about the bad side, would you tell us of the discussions as to that.

Mr. Stevens: I object to the question as calling for a conclusion, but go ahead and answer to the best of your ability.

Mr. Shure: I am not asking for a conclusion. I am asking the witness to tell us what was said at these meetings. That is not a conclusion.

Mr. Stevens: You only asked him for part of what was said on the preceding question.

Mr. Shure: What preceding question?

Mr. Stevens: You said, "Tell us what was said on the bad side." I suggest the proper question is, "What was said to the best of your recollection?"

Mr. Shure: First I will ask about that. He already told us why he thought it was a good plan on the previous deposition.

* * * * *

[285] By the Witness:

A. As a result of the establishment of this new store, the formerly profitable Villa Park store became unprofitable, and the Lombard store incurred substantial losses. It was my

decision that we could not profitably operate two stores in that area. At that time I decided that the Lombard store was the store that we would have to dispose of, because we had certain prohibitions in the lease of the Villa Park store that prevented us from closing that store and not doing business at that location.

Therefore, based on my judgment, I took into account the fact that the leasehold improvements at Lombard would become worthless to us, and, for that reason, wrote off the leasehold improvements, since it was the intention, my intention, which was confirmed by our executive [286] committee, and I believe discussed with our board, that we should proceed to try to dispose of all lease obligation at Roosevelt and Main.

By Mr. Shure:

Q. This is Lombard?

A. Lombard.

Q. Prior to July 31, 1969, you reached the conclusion that the leasehold improvements at the Lombard store should be written off, is that your testimony?

A. That is my testimony. I said Villa Park before in error. The one hundred and thirteen refers to Lombard.

Q. This is what threw me.

A. It would throw you, Mr. Shure. I would apologize, but the thing did go back and forth several times. It is a difficult—

Q. The Lombard store, that is being closed now?

A. It is not. It is the Villa Park store.

Q. What are the leasehold improvements at the Villa Park store?

A. Seventy-seven thousand dollars, to the best of my knowledge. It is right in that area.

[287] Q. So that $113,000 was written off at July 31, 1969, to close the Lombard store?

A. Right.

Q. That, in fact, the decision to close the Lombard store has been reversed, and it is the Villa Park store that is being closed, is that right?

A. That is not correct. The latter part of your question is correct. The previous part of your question is incorrect, or your comment, inasmuch as I still intend to close the Lombard store.

Q. You are going to close both stores?

A. If the opportunity provides itself, yes, sir.

Q. Both Villa Park and Lombard?

A. Yes, sir.

Q. How long a period of time must elapse before you can close the Villa Park store?

A. It will be closed in February.

Q. And at that time, will the leasehold obligations, of which you, to which you referred, no longer exist, being the leasehold obligations that they charged you in closing the Villa Park store in July—which lease is it that contains certain provisions which requires that the business not be discontinued?

[288] A. Villa Park.

Q. All right. Now, at the end of February will those provisions no longer be enforced?

A. As of today, they are no longer in force.

Q. That permits you to close Villa Park?

A. Yes, sir.

Q. Lombard may or may not be closed, is that right?

A. That is correct—well, we have a choice. Whether we will exercise our choice or not is a may or may not.

Q. The final decision has not been made, is that right?

A. No specific action has been taken to close the Lombard store at this time, although we have an interested party to take our position on the lease.

Q. But it may or may not be closed, is that correct?

A. All our stores may or may not be closed.

Q. The Lombard store you stated was under consideration for closing last July?

A. It was very much under consideration.

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[398] Q. Right. I want to know whether, prior to December 5th, were there any discussions with anybody at National, as to whether you would be employed and the terms of your employment by the new corporation?

A. Not specifically with that company. But I don't think that is the answer you want, Mr. Shure.

I probably was not technically aware of this company, whatever the name was and whenever it was formed, that is now TSC Industries, Inc. I am sure I wasn't bothered with that detail.

Q. But you were aware that if the plan was approved by the shareholders of both corporations, that National, in substance, would end up as the owner of the TSC business, correct?

A. Yes, I did understand that.

Q. That was the whole purpose of the vote on December 5th, wasn't it? That is what the voting was about on December 5th, the transfer of the business of TSC Industries, Inc. to National? There were other things voted upon, such as change—

A. It was sales of substantially all of the assets.

[399] Q. Right. So you knew the business was being sold to National in substance, right?

A. Yes.

Q. Now in advance of that meeting on December 5, 1969, did you discuss the question of whether you would continue to be employed by National or its subsidiaries in carrying on the business of TSC Industries, Inc.?

A. No. I did not ask them whether they were going to keep me on or discontinue my services.

Q. Did anyone, connected with National, tell you whether you would be retained or whether your employment would terminate?

A. No one told me my employment would terminate. I think by the confidence that they put with me that I understood that I was going to continue.

Q. What confidence would you suggest they put in you that gave you that, that led you to that conclusion?

A. Well, while under the bylaws, the chairman of the Board was the executive officer, I really functioned as the chief executive officer of the company.

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[406] Mr. Stevens: I object to the form of the question.

By the Witness:

A. I obviously was not chief executive officer, Mr. Shure.

By Mr. Shure:

Q. Under the—

A. Bylaws.

Q. —under the bylaws, but did you perform the duties of the chief executive officer of the company beginning in July 1969?

A. Well, I ran the company, TSC Industries, subject to the Board of Directors and chairman of the Board. I ran it. From time to time we counseled and talked. We had monthly meetings with few exceptions. So there was no huge gap, and I would say the responsibility were probably inferred, at least in my opinion, delegated to me.

Q. What was there left of the duties and responsibilities of the chief executive officer of the company, which you did not perform during the period commencing July, 1969, and thereafter?

Mr. Stevens: Object to the form of the question.

By the Witness:

A. I don't know.

[407] By Mr. Shure:

Q. Since you earlier testified that you acted as the chief executive officer of the company beginning in July and continuing thereafter, can you think of any duty of the chief executive officer that you did not perform from and after July, 1969?

A. I am having difficulty in determining exactly what those duties would be that I did perform and didn't perform.

Q. It is my understanding that you testified a short time ago this afternoon that from and after July, you performed the duties of the chief executive officer of the company?

A. In my opinion, I operated as if I were the chief executive officer of the company.

Q. Did the people of National know you were doing that?

A. I kept no secrets from them, so I presume they knew what I did. Now if they knew that, in my opinion, I felt as if I were the chief executive officer of the company, I don't know. You will have to ask them.

Q. But it is your testimony that in some way they allowed you to carry on and run the company, as though you were the chief executive officer, beginning in July 1969, and continuing thereafter through December 5, 1969?

[408] A. In my opinion, they exercised the same confidences in me, as they would in any chief executive officer.

Q. Did anybody ever dispute your authority during that period?

A. I don't know that the occasion arose for them to dispute my authority. I don't recall.

Q. Did anybody in the TSC Industries object to your acting in the manner which you have testified? Was there an uprising among the other executives for instance?

A. In my opinion, I was received with open arms.

Q. By the other employees of TSC?

A. I would presume most of the employees, yes. I don't know what went through the other men's or ladies' minds. There may have been deep hatred, but I was unaware of it.

Q. Well, there were no confrontations of any kind, no protests or [dissent] expressed, is that right?

A. Oh, Mr. Shure, as president of a company this size, you always receive protests from customers, from clients, if you call

them clients, from employees, employees' friends. It is a continuing thing.

Q. What I am talking about in a protest is objections by employees or directors of TSC, that includes officers, to your carry on the duties and [409] responsibilities about which you have just testified, beginning in July, and continuing through December 5, 1969?

A. In my opinion, there could have been resentment by certain people, but I was there doing a job and not looking for problems.

Q. I do not intend to ask you if you read the minds of any of the people, and I, in all sincerity, I am merely trying to find out if anybody ever came in and said, "Who do you think you are running the company? You are not the boss here. Somebody else is the boss."

Did you ever have that kind of situation develop, either from any of the directors, any of the directors come to you or any of the employees come in and question your authority?

A. They may have. I never understood it, if they did.

Q. Earlier today—just a minute.

(Mr. Shure confers with Mr. Barrett and Mr. Nekritz.)

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[60] IN THE UNITED STATES DISTRICT COURT

Northern District of Illinois

Eastern Division

[Title omitted in printing.]

The continued deposition of WILLIAM E. STIEGELMEIER, called as a witness by the plaintiff herein, taken for discovery purposes pursuant to the Rules of Civil Procedure for the United States District Courts pertaining to the taking of depositions for the purpose of discovery, taken before Edward T. Kinnerk, a notary public and certified shorthand reporter within and for the County of Cook and State of Illinois, taken at the 17th Floor, 134 South LaSalle Street, Chicago, Illinois, on Tuesday, November 30, 1971, commencing at the hour of 10:30 o'clock a.m.

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[103] Q. I take it from the discussion on page 5 that you would agree that the value of the TSC preferred stock should be primarily on the basis of its conversion value as opposed to the yield basis, is that right?

A. No. No. I didn't mean to leave that impression. On a conversion basis, I would say there would be no advantage in converting either from a standpoint of market value or from the standpoint of yield. Standpoint of market value is when the common is worth 13¼, three-fourth's of a share is only $10. And there would be no object in going into a stock with $10. The same way on the income. That is probably what would hold anyone back from converting. There is no point in making conversion and decreasing the income except in the case of Charles E. Schmidt, of course, which he did, but that was a special tax situation with him.

Q. Well you are basing what you just said on the November 7th quoted market price for the TSC preferred and $12, is that right?

A. That is right. I think that that price was fair and reasonable.

[104] Q. Well, that price of $12 is higher than what you would consider to be a value based strictly on yield, isn't that right?

A. Well, it works out that the yield—these yields on convertible stocks in the convertible stock market as a whole do change somewhat from time to time. So that 6.84 per cent yield does not seem to be very high considering the facts that you could have bought 7½ per cent bonds at that time. So that I think that maybe that was a very adequate price.

Q. But it was higher than a strictly yield basis value for the TSC preferred stock, wasn't it?

A. Yes, in my opinion.

Q. So that in your view the TSC preferred stock should not be valued strictly on a yield basis, isn't that right?

A. I would say that it should be primarily on a yield basis and some small consideration for the possibility of conversion. But there is only a small premium for that. I think it is about right.

Q. By small premium for conversion, are you referring to the $3 which is referred to on page 5 of your report?

A. That is right.

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[107] Q. Is that the same list of preferreds that you are going to provide for me from Standard and Poor's?

A. Right.

Q. And is the source of that information the same source as the Standard and Poor's that you are going to provide?

A. Right.

Q. Now on page 6 of your report you indicated that the coverage on the National B Preferred after this transaction for the preferred dividend would be about 5.2 times, is that right?

A. That is right.

Q. And that coverage would be reduced after this transaction from about 12 to 21 times coverage prior to the transaction, right?

A. That is right.

Q. Doesn't that indicate that the value of the National B Preferred prior to the transaction would be reduced as a result of the transaction?

[108] . . . I don't think it matters to the investor at that point whether it is 10 times, 20 times or 30 times after you get past a reasonable margin of safety. I believe that 5.2 for a well deversified company is adequate.

Q. In considering the value of preferred stocks, do you believe it is important to look at the coverage of interest charges for the particular company involved?

A. Well, that would be true, yes. It goes to the soundness. If you did that, you would want to also look at the schedule of maturities and so forth. I think that is a factor, yes.

Q. Is it an important factor in evaluating preferred stocks in your opinion?

A. Yes, I think it is.

Q. Have you computed the interest coverage for National B Preferred as it would be after this transaction?

A. Yes. It would be covered 5.2 times.

Q. Interest, sir?

A. You said on this preferred.

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[356] IN THE UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

[Title omitted in printing.]

The continued deposition of ALLAN B. SOLOMON, called as a witness by the plaintiff herein, taken for discovery purposes pursuant to the Rules of Civil Procedure for the United States District Courts pertaining to the taking of deposition for the purpose of discovery, taken before Edward T. Kinnerk, a notary public and certified shorthand reporter within and for the County of Cook and State of Illinois, taken at Suite 1700, 134 South LaSalle Street, Chicago, Illinois, on Monday, November 29, 1971, commencing at the hour of 10:30 o'clock a.m.

* * * * *

[365] Again, his change of title did not mean a change of function. He has been operating as a legal officer of National since November '67.

Q. So that you were vice president of corporate planning and development at the time that the prospectus of October 3, 1968 was issued, is that right?

A. Yes.

Q. Did you participate in the preparation of that prospectus?

A. Yes.

Q. What was the nature of your participation in that regard?

A. I worked with the attorneys for the company and for Bearnstearns [Bear, Stearns] in the preparation of the prospectus and its filing with the Securities & Exchange Commission.

Q. Was your work in that regard a regular part of your duties and responsibilities as an officer of National?

A. Yes.

Q. Did you review that prospectus in final form prior to the time it was issued?

A. Yes.

Q. At that time did you find anything contained [366] therein with respect to National which you did not believe to be true and accurate?

A. No.

Q. I direct your attention to page 40 of the October 3, 1968 prospectus. The first paragraph on page 40 describes a transaction which was then pending for vote by the shareholders of National and the shareholders of Hawthorn-Mellody with respect to a merger between National and Hawthorn, is that right?

A. Yes.

Q. The second paragraph on page 40—excuse me, I withdraw that.

The first paragraph on page 40 also refers to a transaction similarly pending for approval by the shareholders of National and—

A. Royal School Laboratories.

Q. Yes, the Royal School Laboratories in the form of a merger between National and Royal, is that right?

A. Yes.

Q. There is further reference to those two mergers in the second paragraph on page 40, correct?

A. Yes.

Q. The third paragraph on page 40 begins with the following sentence, which I quote: "National intends to continue to seek to acquire other businesses [367] and product lines for cash or securities or both, of kinds and types deemed advantageous by management."

Was that statement true at the time it was made, Mr. Solomon?

A. Yes.

Q. Now a prospectus—excuse me, a proxy statement, to be more precise was issued in connection with the Hawthorn-Mellody-National merger on September 27, 1968, was it not?

A. Yes.

Q. For the record I will show you now a copy of that proxy statement with respect to a special meeting of the shareholders of National-Hawthorn-Mellody and Royal School Laboratories having previously been marked as Exhibit 102.

Mr. Solomon, you were vice president, corporate planning and development at the time that this proxy statement was issued, were you not?

A. Yes.

Q. Did you participate in the preparation of that proxy statement?

A. Yes.

Q. Was your participation in that regard essentially the same as that which you have described with respect to the October 3, 1968 prospectus?

[368] A. Yes.

Q. I direct your attention to page 3 of the proxy statement and in particular to the first paragraph under the heading "Proposed Mergers" and the subheading "Hawthorn Merger." The last sentence in that paragraph reads as follows: "The Board of Directors of National believes that the merger is consistent with its program of acquiring complete ownership of business wherever feasible."

Did I read that correctly?

A. You did read it correctly.

Q. Was that statement true at the time it was made?

A. Yes, it was.

Q. Now on page 5 of this same proxy statement the first paragraph under the heading, "Royal Merger" contains the following sentence: "The Board of Directors of National believes that the merger is consistent with its program of acquiring complete ownership of businesses wherever feasible."

That is the same statement that appeared an page 3, is it not?

A. It is identical, yes.

Q. Was that statement true at the time it was [369] made?

A. Yes, it was.

Q. Now, sir, I show you a looseleaf book which is entitled "NII Corporate Management Guide Policies and Procedures," and which has previously been marked as Exhibit No. 225 in this case.

Are you familiar with this policy guide?

A. I have never read the policy guide, but I do have a copy of it in my office.

Q. Did you participate in the preparation of that document?

A. Absolutely not.

Q. Was that document prepared under the direction of Mr. Simonelli?

A. Yes, it was.

Q. Mr. Simonelli was then the executive vice president of National, is that correct?

A. Yes.

Q. That document was issued approximately January 15, 1969, is that correct?

A. That is what that says. I don't remember when it was issued.

Q. In looking at various of the pages here, there are various dates. The earliest date which [370] appears with some frequency was January 15, 1969. Does that appear to be correct?

A. Well, without going through the pages, let the document speak for itself.

Q. Wasn't there a National Management Seminar or Meeting being held at about Janaury 15, 1969?

A. Yes. It was right around that time.

Q. Did you attend that meeting?

A. Yes, I did.

Q. Where did that meeting take place?

A. Biloxi, Mississippi.

Q. Was this management guide circulated at that meeting?

A. To the best of my recollection, it was.

Q. Under the heading of "Corporate Goals" on a page which is designated MG-CG-1 January 15, 1969, the first item under the heading "1969 Corporate Goals" is stated as follows:

"An acquisition program which together with existing operations will bring National's annualized sales to over five million dollars." Is that right?

A. You are reading the statement correctly.

Q. Under the same heading on page MG-CG-3 dated January 15, 1969, there is a reference to what [371] are called "long-term corporate goals," correct?

A. Yes.

Q. The first paragraph on that page is one sentence, and it reads as follows: "The long-term corporate goals are to achieve one billion dollars in sales by 1972 through internal acquisition expansion of $500 million dollars from existing businesses and $500 million dollars from acquisitions." Did I read that correctly?

A. Yes.

Q. Following that is a statement which in part reads as follows: "To achieve a sales contribution by 1972 of . . ." and then there are five different fields. The first one is, "Consumer 40 per cent, $400 million dollars." The second one, "Retailer, 20 per cent, $200 million dollars," correct?

A. Yes.

Q. Mr. Solomon, were the statements that I read from page MG-CG-3 true at the time they were made? That is on January 15, 1969?

A. I had no responsibility for the preparation of that document, nor must I say was any draft submitted to me for either approval or disapproval. I don't know who prepared the documents. I cannot [372] comment as to their accuracy or non-accuracy.

Q. Were you a member of the National staff at that time, weren't you?

A. Yes.

Mr. Dixon: Mr. Block, I am going, just for the record, to impose an objection on this. The witness started off by saying that he never read the document which you have been interrogating him on here in the last five minutes. It is my recollection that this document was reviewed in extensive detail with Mr. Simonelli when it was produced.

By Mr. Block:

Q. At that time you were in day-to-day contact with both Mr. Yarmuth and Mr. Simonelli in connection with the objections of National, were you not?

A. As it related to my position, yes.

Q. Do you believe that any part of the statement which I have read from page MG-CG-3 just now was not true on January 15, 1969?

A. National, at that time, was essentially looking for acquisitions. As to the breakout or the amounts specified therein, I can say that I had no particular goals for National and really don't know [373] how those specific figures or percentages were arrived at.

Q. Did you question anybody about those statements?

A. Having never seen it until just now, no.

Q. You did not see those statements when this document was circulated at the NII Management Seminar in Biloxi?

A. I got a copy of the document, but I don't remember reading it.

Q. While you were at the seminar, you and others made a trip to Boca Raton to meet with Mr. Schmidt, isn't that right?

A. Yes.

Q. You met with Mr. Schmidt at his home in Boca Raton on January 16, 1969, is that right?

A. I don't recall the day, but it was sometime during that week that we were in Mississippi, yes.

Q. National representatives who met with Mr. Schmidt at that time were Mr. Yarmuth who was then president and chief executive officer of National, Mr. Ivan Greenspan, who was then a vice president of National involved in acquisitions, Mr. Simonelli who was then executive vice president [374] of

National, Mr. David King who was active in one of National's retailing subsidiaries and yourself, is that right?

A. Yes.

Q. Is it also correct, sir, that when you were on Boca Raton at that meeting with Mr. Schmidt, you delivered to him a copy of the National prospectus of October 3, 1968, which is dated —excuse me, marked as Exhibit No. 233 in this case?

A. I don't remember if I delivered a copy to him or not.

Q. You mean you personally?

A. Yes. It was a public document. I don't remember if we delivered one to him or not in connection with the acquisition.

Q. His testimony was, in a prior deposition, that you did deliver him a copy of this prospectus.

A. Well, it may well be. I just don't have any independent recollection of it.

Q. You don't dispute that statement, though?

A. No, I do not.

Q. During the course of that meeting with Mr. Schmidt in Boca Raton, did you or any of National's representatives tell Mr. Schmidt about National's [375] acquisition policies and programs?

A. I don't recall.

Q. Did Mr. Schmidt ask about those matters or inquire?

A. I don't recall.

Q. During the meeting with Mr. Schmidt, was there any discussion with respect to whether or not National might, should it acquire the shares of TSC, subsequently attempt to acquire the balance of the assets or stock of TSC Industries?

A. Not that I can recall.

Q. During that meeting did Mr. Schmidt inquire whether National would or might attempt to acquire the balance of TSC if it purchased his shares and those of his family?

A. I don't recall.

Q. During that meeting, did Mr. Schmidt require that National agree in the event that it did attempt to acquire the

balance of TSC, either stock or assets, to do so in a manner which would afford to the other shareholders of TSC at least the same values that would be afforded to Mr. Schmidt and members of his family in connection with National's purchase of their shares?

[376] A. No.

Q. Did Mr. Schmidt or anyone on his behalf ever make any such request of National at any time up to the time that the Schmidt agreement was executed on January 31, 1969, and with respect to which National acquired the Schmidts' shares of TSC?

A. Our entire deal with Mr. Schmidt is set forth in the acquisition agreement. If there is nothing in there covering it, then there is no other letter or understanding.

Q. Well, did Mr. Schmidt or anyone on his behalf attempt to obtain such an understanding from National at any time?

A. I don't recall. I do not believe so, no.

Q. Did Mr. Schmidt or anyone acting on his behalf ever inquire as to whether National intended to attempt to acquire the balance of the TSC shares or assets if it purchased the Schmidt shares either during the meeting in Boca Raton or any other time up to the time of the signing of the Schmidt agreement on January 31, 1969?

A. Not to my knowledge.

Q. Mr. Solomon, I show you now a copy of a series of 12 pages of handwritten notes which together have [377] been marked previously as Exhibit No. 155 in the deposition record of this case. Would you please take a look at Exhibit No. 155.

A. OK. I have read it. I have looked at it.

Q. A number of those pages are in your handwriting, are they not?

A. Yes, that is true.

Q. Now looking at page No. 2, sir, is Page No. 2 in your handwriting?

A. Yes, it is.

Q. Do you recall when you made those notes which appear on page 2?

A. No.

Q. Were they made prior to your meeting with Mr. Schmidt on January 16th or thereabouts?

A. No. No.

Q. Were they made thereafter?

A. Yes.

Q. Were these notes made in connection with any of the meetings which occurred with Mr. Schmidt and representatives of National during the following weeks in New York City?

A. I don't remember when—I don't remember the exact date that I did make up this sheet, but it was [378] obviously sometime between the time that we met with Mr. Schmidt in Florida and when we presented our group of nominees for the board of directors.

Q. When did that occur?

Would it assist your recollection to have me point out that the closing of the purchase of the Schmidts' shares took place on February 7th in Chicago, and that there was a meeting of the TSC Board of Directors on February 5th in Chicago—1969?

A. You mean there was a meeting prior to the closing of the contract?

Q. Yes.

A. I don't remember what action they took at that meeting.

Q. Well, do those facts assist you in your recollection as to when you presented your group of nominees to the—

A. No. No. No. It was sometime prior to the time that they sent out new proxy material as I remember.

Q. For the record I show you a copy of a document previously marked as Exhibit No. 8 which is titled TSC Industries Notice of Adjourned Annual Meeting of Stockholders and dated March 7, 1969, with the [379] attached proxy material. Is this the new proxy material which you were referring to?

A. Yes.

Q. So that your recollection is that you presented your group of nominees on behalf of National sometime prior to March 7, 1969, is that right?

A. Yes, that is true.

Q. I take it then that you do not now recall whether that occurred prior to or after the closing on February 7, 1969.

A. That is right. I don't recall.

What was the date of the meeting that we attended?

Q. Exhibit No. 15 in this deposition record is a copy of the minutes of a special meeting of the board of TSC Industries, Inc. dated February 5, 1969.

Does that refresh your recollection?

A. Yes.

Q. What is your present recollection as to when you presented your management for or nominee group?

A. It was prior to February 5.

Q. Of 1969?

A. Yes.

Q. Thank you. Now does a review of the documents [380] we have just looked at assist your recollection as to when you prepared the notes of page 2 of Exhibit 155?

A. It was sometime prior to February 5th.

Q. That is the best you can recall?

A. 1969.

Q. Is that the best you can recall?

A. Yes.

Q. Now page 4 of Exhibit 155 contains a number of computations. Are those in your handwriting?

A. Yes.

Q. What is the computation on page 4?

A. Well, there are several computations. I was doing a computation of the converted book value per share of the common stock of TSC as you can see. I converted the preferred stock into its equivalent shares of common stock; added that to the then outstanding shares of common stock and divided that by the net worth at October 31, '68 of TSC.

Q. And that resulted in an indicated figure of $9.25 per share, is that right?

A. That is right.

Q. Did you also do the computations which appear on the following page of Exhibit 155 which does not have a number?

[381] A. Yes.

Mr. Block: Counsel, if there is no objection, I will just add a designation to this page as 4-A so it bears some identification.

Mr. Otis: No objection.

Mr. Dixon: No objection.

By Mr. Block:

Q. What is the subject of the computation on page 4-A of Exhibit 155?

A. It purports to set forth the shares that were owned by Mr. Schmidt and his family converting the preferred shares to common shares, and coming to a total. There was also computations on the left-hand side of the page that I don't know what that represents.

Q. You are referring to those which appeared in the box?

A. Yes.

Q. Did you also make the notes and do the computation which appears on page 5 of Exhibit 155?

A. Yes.

Q. What is the subject of that computation?

A. The computation is of the purchase of shares of common at $30 a share. Purchase shares of preferred at $22.50 a share and a computation of a down payment [382] of approximately 30 per cent.

Q. $30 per share is the price which National paid Mr. Schmidt and members of his family for the Schmidts' common shares of TSC, is it not?

A. I believe that is correct.

Q. $22.50 is the per share price paid by National to Mr. Schmidt and members of his family for the Schmidts' preferred shares of TSC, is that correct?

A. Yes.

Q. In that acquisition, the Schmidt family was also given 125,000 warrants to purchase National common stock at $24 per share exercisable between the fifth and sixth years of National's notes to the Schmidt family, is that right?

A. Yes.

Q. Did you do the computation which appears on page 6 of Exhibit 155?

A. Yes.

Q. What is the subject of those computations?

A. It shows a computation of shares that we would buy as related to the outstanding issue of preferred stock and common stock as well as the percentage of each class and a percentage of the total votes that we would have in the company.

[383] Q. You mean if you purchased the Schmidts' shares?

A. Yes.

Q. So that on that basis the computation on page 6 of Exhibit 155, National acquired 42 per cent of the outstanding TSC preferred stock, 27 per cent of the outstanding TSC common stock and combined voting rights with respect to 33 per cent of the total outstanding stock of TSC Industries, is that right?

A. Yes.

Q. Similarly, Mr. Solomon, did you do the computations which appeared on page 7 of Exhibit 155?

A. Yes.

Q. What is the nature and subject of those computations?

A. The first computation I believe is a computation of the excess purchase price to be paid in connection with the acquisition.

The second computation converts the preferred shares to common stock and then explores the issuance of one and a

third National shares for each converted share of TSC with the conclusion that on that basis each share of TSC would be bringing to National $1.50 for each share that we issued.

Q. Now the first computation which you mentioned [384] is an excess purchase price?

A. Yes.

Q. What do you mean by excess purchase price?

A. That to the extent that we were paying Mr. Schmidt or the extent to which we were purchasing shares over the then book value of the TSC stock.

Q. What is the premise of the second computation on page 7 which explores the issuance of one and one-third shares of National for each share of TSC acquired?

A. I am not sure I understand your question.

Q. Why did you make the second computation on page 7?

A. The reason for the computation on page 7 was made to explore the possibility of acquiring all the shares of TSC.

Q. You mean the Schmidt Family shares and all other shares of TSC?

A. Yes.

Q. On what basis—what basis was used in exploring that possibility in this computation?

A. I did it on the basis of exchanging one and one-third shares of National per each converted share of TSC.

Q. You mean for each converted share of TSC [385] other than the Schmidt Family shares of TSC?

A. Yes. Yes, that is correct.

Q. Did anyone ask you to explore that possibility?

A. I don't recall.

Q. Did you discuss the computation with anyone?

A. I probably did.

Q. With whom?

A. With either Mr. Greenspan or Mr. Yarmuth.

Q. Do you recall when you discussed it?

A. No.

Q. Was it prior to the meeting with Mr. Schmidt on January 16, 1969?

Mr. Dixon: I object to that. He already has been asked and testified that he didn't recall when these papers were prepared. He said that they were not prepared before but at some time after, I believe. The record is clear on that. You can ask him again.

Mr. Block: Well, I would just point out to you, Mr. Dixon, that the statement that you are referring to was made with respect to page 2 of this Exhibit 155.

Mr. Dixon: I thought his testimony was after looking at all of the papers that he did [386] not recall as to when they, referring to each of them, were prepared. And then you spent a good deal of time attempting to refresh his recollection as to when they may have been prepared.

Mr. Block: Excuse me, I think the record will show the facts but I believe it is as I stated it.

Would you read the last question, please.

(Question read.)

By the Witness:

A. I do not believe so. On what, January 16th? I don't believe so.

By Mr. Block:

Q. Was it during the following period from the date of that meeting until the end of the next week?

A. I believe it was immediately subsequent to my meeting with Mr. Schmidt because these statements are down on Broad Water Beach stationery.

Q. Did your group stay at the Broad Water Beach at Biloxi?

A. Yes.

Q. What was the content of the discussion [387] between you and Mr. Yarmuth and Mr. Greenspan as best you recall it in connection with this computation?

A. Once we were furnished information regarding TSC, as you can see, I was doing computations on the costs to us of the shares and some computations on the basis of the proposed acquisition of all the shares.

Q. Now, sir, the computations which appear on Exhibit 155, pages 4, 4-A, 5, 6, 7, 8 and 9 are all on Broad Water Beach Hotel stationery, correct?

A. Yes. Yes.

Q. Did you do all of these computations?

A. No.

Q. At the same time?

A. I didn't do all the computations.

Q. Did you do the computations on page 8?

A. No.

Q. Did you do the computations on page 9?

A. Yes.

Q. But for those on page 8, did you do all of the computations that show on those pages at the same time?

A. Within a span of a day or two, yes.

Q. So that all those computations were made while you were in Biloxi?

[388] A. Yes.

Q. And all of them were made immediately after the meeting with Mr. Schmidt on January 16, is that correct?

A. Within several days thereafter.

Q. Were any of those computations made prior to the January 16th meeting with Mr. Schmidt?

A. I don't recall, but I don't believe that I had the necessary financial information to make that computation.

Q. Did you receive any financial information during the January 16 meeting with Mr. Schmidt?

A. Yes.

Q. Was that in the form of a preliminary prospectus?

A. Yes.

Q. Relating to the possible or proposed public sale of certain common shares of TSC Industries, Inc.?

A. Yes.

* * * * *

[403] Q. What was the reason for your jotting down their names, if you recall?

A. I believe that I jotted the names down because they were the two operating officers of TSC.

Q. Is that your present recollection?

A. Yes.

Mr. Block: Off the record for a second.

(Discussion off the record.)

By Mr. Block:

Q. You mentioned a moment ago in connection with page 12 of this Exhibit 155 that there was a question as to whether for accounting purposes National needed to place a value on the warrants given to the Schmidt family, is that right?

A. Yes.

Q. What did you conclude with respect to that matter, if anything?

A. It was up to the financial people to make the decision.

Q. Did you participate in the decision which was made as to recording these warrants for accounting purposes?

[404] A. I don't believe that I did.

Q. Did you have anything to do with placing a value on the Schmidt warrants?

A. No. I think that the company got an opinion from someone as to the value, if any, of the notes and the warrants or the warrants separate.

Q. I show you a copy of a document previously marked in this deposition record as Exhibit No. 373, which is a copy of a letter dated March 31, 1969, addressed to you from a Mr. Matthews of Bear Stearns and Company. Is that the opinion which you are referring to?

A. Yes. Yes.

Q. Did you request this opinion?

A. On behalf of the accounting department, yes.

Q. Did you discuss the contents of this exhibit or this opinion with anyone?

A. Of course.

Q. With whom?

A. The people at National Industries.

Q. Specifically?

A. Certainly with the financial department. It was on their basis—it was at their request that I apparently asked Mr. Matthews to supply a valuation.

[405] Q. Do you recall asking Mr. Matthews or anyone at Bear Stearn for this evaluation?

A. I must have if he addressed the letter to me.

Q. That is your best recollection?

A. Yes.

Q. Do you recall what you said to the financial people at National and what they said to you with respect to this matter?

A. I gave them a copy of the letter.

Q. Is that all?

A. I can't recall anything else.

Q. Now this Exhibit 373 expresses the opinion of Bear Stearns that the warrants issued in the Schmidt transaction are worth about $2.25 each, is that right?

A. That is what it says.

Q. Do you know what value was placed on those warrants for accounting purposes when the transaction was recorded on National's books?

A. Not without looking at the financials.

Q. Mr. Solomon, I direct your attention to the joint proxy statement of November 12, 1969, which was issued in connection with the transaction which is the subject matter of this litigation and parti- [406] cularly with respect to page 63, which contains a statement of consolidated stockholders' equity for National Industries and its consolidated subsidiaries. You note the entry on this page which is designated "Issuance of warrants

to acquire up to 125,000 shares of National common stock in connection with the purchase of shares of TSC stock, $140,000"?

A. Yes.

Q. That refers to the Schmidts' warrants, does it not?

A. Yes.

Q. And the value at which the Schmidts' warrants were recorded for purposes of accounting on National's books was, therefore, approximately $1.12 per warrant, is that right?

A. I haven't done a computation, but apparently we placed a value of it at $140,000.

Q. Now I show you a copy of an exhibit previously marked as Exhibit 223 in the deposition record of this case which is a single sheet of handwritten notes. Are any of these notes in your handwriting?

A. Yes.

* * * * *

[429] Q. He was there, was he not?

A. I believe so.

Mr. Block: Off the record.

(Discussion off the record.)

Mr. Block: I would like to ask one more question and then come back to this discussion.

Mr. Otis: Do you want the witness or me?

Mr. Block: Him.

Q. Mr. Solomon, during the meeting with Mr. Schmidt in his home in Boca Raton on January 16, 1969, did Mr. Schmidt suggest to National that he might be able to obtain for you other shares of TSC from persons known to him should you be interested in purchasing them?

A. Yes.

Q. What did he say and what did you gentlemen say in that respect?

A. I believe that this was covered in my previous deposition.

Q. Excuse me if I suggest to you that it was not, but can you tell me briefly what occurred in that connection?

A. Mr. Schmidt said that there would be other [430] shares available for purchase from friends and associates of his at the same price if we desired to purchase such shares.

Q. Did he say how many approximately would be available?

A. In round numbers, I believe around 100,000 shares.

Q. Did he say who owned those shares?

A. He mentioned specifically Mr. Abbott.

Q. That is Gardner Abbott?

A. Yes.

Q. He was then chairman of the board of TSC, is that right?

A. Yes.

Q. Did he mention anyone else?

A. No, not to my knowledge. Not that I can recall.

Q. And what response, if any, was made by the representatives of National?

A. We couldn't purchase additional shares.

Q. Did that subject come up during the other discussions between Mr. Schmidt and the representatives of National?

A. No. We told Mr. Schmidt that we could only purchase shares owned by him and his immediate family.

* * * * *

UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division at Chicago

[Title omitted in printing.]

DEPOSITION OF ALLAN B. SOLOMON
TAKEN BY PLAINTIFF

Louisville, Kentucky
December 16 and 17, 1971

* * * * *

[10] A. Only to the extent that I believe that the attorneys for TSC had a copy of our 13-D.

Q. You mean the document which has been marked as Exhibit 49, is that right?

A. That is true.

Q. And at the time that you reviewed this prospectus prior to the date on which it became effective you held the position as Vice-President, Corporate Planning and Development for National, did you not?

A. Yes, I did.

Q. Now, Mr. Solomon, I would like to direct your attention to a document previously marked as Exhibit Number 242, being a form of questionnaire dated February 3, 1969 and with respect to TSC Industries, Inc Mr. Solomon, there are some handwritten entries on the answer line to these questions. Do you recognize that handwriting as being your own?

(Document handed to the witness.)

A. Yes.

Q. Are there any entries in document 242 which are not in your handwriting? I am referring now to the handwritten entries.

A. No.

Q. Now, this questionnaire was submitted [11] to you by the firm of Bell, Boyd, Lloyd, Haddad & Burns in connection with the work of that firm relating to the public offering which is described in Exhibit Number 48, the March 18, 1969 prospectus, is that right?

A. In part.

Q. What did I leave out?

A. It was also submitted in connection with the preparation of the proxy statement of TSC Industries, Inc., for the 1969 annual stockholders meeting.

Q. Do you mean the meeting of the stockholders of TSC Industries, Inc., to be held March 31, 1969?

A. Yes.

Q. Do you recall when you completed this questionnaire and returned it to the Bell-Boyd firm?

A. I have no independent recollection.

Mr. Morency: Would you identify the document the witness and you are reading?

Mr. Block: Yes. This is a letter dated February 17, 1969 to Mr. Solomon from Mr. Avery of the Bell-Boyd firm, the second paragraph of which reads "In case you have overlooked my other request, we will want to have a questionnaire filled [12] out by National Industries itself since it holds more than 10 per cent of the stock of TSC."

Mr. Morency: Is the document—

Mr. Block: Excuse me, Mr. Morency. My reason for showing this document to Mr. Solomon is simply to see if that would help him with his recollection as to when he did complete and return the document which has been marked Exhibit 242. Does that help you?

A. I submitted it sometime subsequent to February 17, 1969.

Q. Was it during the month of February, 1969?

A. I don't recall. Is there no cover letter in my files indicating when I returned the questionnaire?

Q. I am doing my best to help you with that. If I had that date I would suggest it to you. But you do recall, as I understand you, that you returned the questionnaire sometime after February 17, 1969?

A. Yes.

Q. Was it reasonably soon thereafter?

Mr. Dixon: Objection. He said he didn't recall.

[13] A. I don't recall, but I do know that it was submitted prior to the registration statement being effective.

Q. You mean prior to March 18, 1969?

A. Yes.

Q. O.K. And was the form of this questionnaire which you submitted to the Bell-Boyd firm answered with the same answers that appear in Exhibit 242 to the various questions which are stated?

Mr. Morency: Mr. Reporter, will you reread that question, please?

(Whereupon, the preceding question was read by the reporter.)

Mr. Morency: I object to the question on the ground the witness has already testified that the answers which appear on 242 are writen in his own handwriting, and that his handwriting alone appears on the exhibit, except for the identification made by the Reporter.

Q. Subject to Mr. Morency's objection would you please answer the question?

A. Well, this document is apparently incomplete in that it refers to enclosed papers which are not attached to the document, but this questionnaire does conform from page 1 through 8 to the—and [14] are the exact answers that I gave in the copy that was submitted to the Bell-Boyd law firm.

Q. Thank you. Now, Mr. Solomon, directing your attention to item number 17, that question reads "To your knowledge has there been a change in the control of TSC since October 31, 1967?" The answer reads in your handwriting, "Yes. See enclosed papers." Did I read those two statements correctly?

A. Yes.

Q. Now, you have pointed out that the enclosed papers are not attached to Exhibit 242. Can you tell me what those papers were as submitted to the Bell-Boyd firm?

A. I don't remember.

Q. Have you any recollection whatsoever?

A. No.

Q. Did the papers include a copy of the agreement of January 31, 1969 between National and the Schmidt defendants—

Mr. Morency: Objection. He has already testified he doesn't remember and, further, that he has no recollection of what those papers were.

Mr. Block: It seems to me, Mr. Morency, that that is a very fine foundation for properly refreshing the witness's recollection, and by your [15] leave I would just like to see if we can help him with it.

Mr. Morency: He may answer subject to the objection.

Mr. Block: Do you want to read my question back?

(Whereupon, the preceding question was read by the reporter.)

Q. (Continuing)—whereby National acquired the shares of TSC Industries owned by the Schmidt defendants?

A. Possibly.

Q. Do you recall whether any of the enclosed papers referred to the acquisition by National of the Schmidt shares in TSC?

A. I do not know the papers—I do not recall the papers that were submitted, but I do know that they—that my comment related to the acquisition by National of the Schmidt shares.

Q. By "comment" you are referring to the answer that you wrote here in answer to item 17?

A. Yes.

Q. Did your answer relate to anything else?

A. I do not recall.

• • • • •

[148] A. I don't recall.

Q. Do you recall whether you discussed with Mr. Merkle National's plans with respect to Hawthorne-Melody [Hawthorn-Mellody] acquisition in 1968, that is, the purchase of Hawthorne-Melody [Hawthorn-Mellody] stock?

A. No.

Q. Do you recall whether you discussed with Mr. Merkle National's plans with respect to the merger of Hawthorne-Melody [Hawthorn-Mellody]?

A. I didn't.

Mr. Morency: You did not?

The Witness: No.

Q. Do you know whether, or do you recall whether you discussed with Mr. Merkle the acquisition by National of Nelson Sales or any affiliated corporations?

A. I did not.

Q. You say you did not discuss that with Mr. Merkle?

A. That's right.

Q. Did you ever have any discussion or conversation with Mr. Merkle concerning any purchases by either Mr. Merkle or Madison Fund of National's shares during 1968, that is, common shares of National?

A. No.

[149] Q. Did you discuss—do you recall whether you discussed with Mr. Merkle any of the acquisitions which National either made or contemplated making during 1969?

A. I don't believe I did.

Q. Do you recall whether you had any discussions with Mr. Merkle during 1969 concerning any purchases of National common stock by Madison Fund or by Mr. Merkle?

A. I did not.

Q. Were you aware of the fact that Madison Fund was purchasing National common during 1968?

Mr. Morency: Objection, unless you pinpoint the time in which you refer to.

Q. At the time or about the time the purchases were being made.

A. Yes.

Q. How did you come to be aware of those purchases?

A. I saw the purchases on the transcriptions.

Q. Are those transfer sheets periodic reports you receive from transfer agents?

A. Yes.

Q. How frequently did you receive those [150] reports?

A. Whenever the transfer agents got a bunch of them together.

Q. Was it daily?

A. I don't—we received several transfer sheets during a week's time, yes.

Q. Generally speaking every week you would receive some transfer sheets, it that right?

A. Yes.

Q. I take it that is true also during the year 1968?

A. That is my recollection, yes.

Q. Is that also true during the year 1969?

A. Yes.

Q. So that you were aware of the purchases by Madison Fund of National common stock during 1969 at or about the time the purchases were being made, is that correct?

A. Well, I didn't necessarily know when the purchases were being made. I knew when the transfers of the shares were made on the books of the corporation.

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UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

[Title omitted in printing.]

DEPOSITION OF STANLEY YARMUTH
TAKEN ON DISCOVERY BY PLAINTIFF

Louisville, Kentucky
October 20 and 21, 1970

• • • • •

[49] Q. Mr. Marshall is not active in the day-to-day management of National?

A. No.

Q. Mr. Yarmuth, the initial interest which National acquired in TSC Industries was purchased from Mr. Charles E. Schmidt and the members of his family, is that correct?

A. Yes.

Q. Were you active in the acquisition of that stock from Mr. Schmidt?

A. Yes.

Q. How did the National Industries first become acquainted with Mr. Schmidt?

A. Mr. Schmidt?

Q. Yes.

A. Well, we first became acquainted with Mr. Schmidt when we met him to negotiate the deal.

Q. When was that?

A. I imagine the middle part of January, middle or latter part of January.

Q. Of 1969?

A. Yes.

Q. Did Mr. Schmidt or someone on his behalf call National or approach National?

[50] A. Yes. I think there was a broker in New York, and I don't remember the name, seems to be Pershing, but I—soneone who was a friend of Simonelli contacted Simonelli about the acquisition.

Q. Do you know when that was?

A. I imagine in the middle part of January.

Q. Was that by telephone?

A. I don't know.

Q. What was the nature of this contact by the broker?

A. Of course—

Mr. Stevens: Object.

Q. Was that Mr. Solomon that was contacted?

A. Simonelli.

Q. Did Mr. Simonelli tell you about the conversation with the broker?

A. Yes.

Q. What did he report to you concerning that conversation?

A. As I recall, he reported to me that a broker called him and indicated to him that there was a block of stock in TSC Industries that may be available, would we be interested.

Q. And what did you or anyone on behalf of National Industries next do concerning the potential [57] purchase of the Schmidt shares in TSC?

A. I would assume that we immediately went to Standard & Poor's and got an annual report and whatever other information that was available about the company, did a cursory examination on the company, and I would guess that we contacted or Simonelli contacted the broker in New York and indicated that we may have an interest.

Q. Did you do that research personally?

A. No.

Q. Do you know who did do that research?

A. No, but probably our financial men.

Q. Mr. Greenspan do any of that?

A. I really don't recall.

Q. Did Mr. Trubey?

A. Same thing. I don't recall.

Q. Did you ask anyone specifically to do that?

A. In all probability, I did, which is my usual custom.

Q. Do you recall who you asked to do that work?

A. By my first two statements, I don't recall, so I certainly don't recall.

Q. Have you any way of refreshing your [52] recollection as to that?

A. You may ask every individual in the company who I asked, and one of them probably will recall.

Q. Did someone report back to you as to the results of that research?

A. I am sure they did.

Q. You do not recall who that was?

A. No.

Q. Was the result of that research submitted to you in written form?

A. Probably a semi-written form.

Q. Mr. Yarmuth, what do you mean by semi-written form?

A. Sometimes they will come in with a yellow sheet saying—breaking down generally the capital structure, shares outstanding, et cetera, and some sort of a conclusion that may or not fit our company, you know, we don't have a price or anything else, and expressing an interest or a positive go forward and pursue.

Q. Do you recall receiving that sort of a—

A. No, I don't recall, but ordinarily it happens.

[53] Q. Who would you normally ask to report back to you?

A. Ordinarily Trubey or Greenspan or Solomon.

Q. Or Mr. Solomon?

A. Yes.

Q. Do you recall in this instance whether Mr. Solomon was the man who reported back to you in this connection?

A. No.

Q. What did you next do concerning the acquisition of the Schmidt shares?

A. I probably then told Simonelli, who was the original person contacted, to contact his source and tell them that we expressed an interest in going forward with further talks.

Q. Do you recall doing that?

A. Not directly, but I assume—that would be my normal procedure.

Q. Did Mr. Simonelli, as far as you recall, carry out that instruction?

A. Simonelli or someone else did it, because contact was made to us subsequent to that.

Q. What happened next?

A. As I recall it, we were at a president's [54] seminar in Biloxi, and I don't recall the dates, but it was not very long afterward that Mr. Schmidt would be available for a meeting, and that Mr. Schmidt was going to Europe one or two days thereafter, and it was urgent that if we were interested in it to get to see Mr. Schmidt within the next day or two or whatever it may have been. At that time we were at a president's seminar in Biloxi, as I said. We then made arrangements to fly from Biloxi to Palm Beach one afternoon—don't ask me the date, I don't remember—and meet with Mr. Schmidt that afternoon.

Q. Where did this meeting take place?

A. In Mr. Schmidt's home in Palm Beach.

Q. Who was present?

A. As I recall, the two brokers, and I don't recall their names. Mr. Schmidt, Mr. Dave King, Mr.—I think Greenspan —I think Mr. Solomon and Mr. Simonelli and myself.

Q. Who is Mr. Dave King?

A. Mr. Dave King was president of our Retail Centers operation.

Q. What occurred at that meeting concerning the shares of TSC which were owned by Mr. Schmidt and members of his family?

A. As I recall, Mr. Schmidt expressed an [55] interest in selling the shares of his and his family's, and in the conversation indicated that he would be willing to sell on a cash and term basis and also indicated the urgency in our making a decision quickly, because he was doing a secondary with Hornblower & Weeks, and the red herring already was printed, necessitating a quick decision on our part.

Q. By "red herring", Mr. Yarmuth, are you referring to a preliminary copy of a prospectus?

A. Yes.

Q. With respect to the sale or potential sale of shares of TSC?

A. Through an underwriter.

Q. Including the shares owned by Mr. Schmidt and his family?

A. Yes.

Q. Are you referring to a form S-1, registration statement, under the Securities Act of 1933 with respect to potential sale of 355,000 shares of common stock in TSC Industries, Inc.?

A. If that was the red herring, if that was the red herring that was published, that's the one I am referring to.

Q. Did you see a copy of the prospectus?

A. You mean at that meeting?

[56] Q. Yes.

A. Yes, he gave us a copy of it.

Q. I understand that Mr. Schmidt gave you a copy of the red herring at that meeting, is that correct?

A. Yes.

Q. Had you seen a copy of it before that time?

A. No.

Q. As far as you know, had anyone connected with National Industries?

A. Not to my knowledge.

Q. Did you discuss with Mr. Schmidt the price at which either you would buy or he would sell his shares?

A. Yes.

Q. What was the nature of the discussion concerning the price?

A. Well, of course, as negotiations go, I really couldn't give you the specifics of what we initially thought it was worth and what he initially thought it was worth, but as I recall we finally got to a ball park number of about $30 a share, and I don't recall the exact numbers.

Q. Well, when you went to that meeting, [57] had you formed an opinion as to what you might be willing to pay for the shares owned by Mr. Schmidt and his family?

A. Well, a ball park number, you never know, you never define an exact dollar price. You certainly are not as familiar with the company as you should be, and certainly you are talking ball park numbers initially at the initial meeting.

Q. Did you discuss that ball park figure with anyone connected with National Industries, Inc. prior to the time you met with Mr. Schmidt?

A. Probably, in all probability we did.

Q. With whom did you discuss it?

A. I imagine we discussed it on the plane coming down to Palm Beach.

Q. Did you discuss it prior to that time?

A. Well, I don't recall, because the time that we made the initial deal, we may have come up with ball park numbers, and it was just something in the embryonic stage and it wasn't of any real consequence. When the meeting was called to meet with Schmidt, and leaving the president's seminar, I imagine in that few hour period we did bandy around some ball park numbers.

Q. Am I correct that at the time you first [58] went to meet with Mr. Schmidt in his home that you had, you and the National—

A. Group.

Q. —group, had not done anything other than what you have told us concerning the potential acquisition of Mr. Schmidt's shares?

A. As well as I can remember.

Q. Do you recall the ball park figure that you had decided you would be willing to pay for Mr. Schmidt's shares?

A. I think we really talked of a ball park area rather than a number, and I don't recall the exact numbers, but I am sure we started on a low basis and he started on a high basis and we probably both bent somewhat.

Q. Do you recall where you started at that meeting?

A. No.

Q. Do you recall where Mr. Schmidt started?

A. It was higher than what we ended up paying, but I don't remember the exact figure.

Q. Well, did you reach a figure at that time?

A. A tentative figure, yes.

Q. What was the figure you reached with [59] Mr. Schmidt at that time?

A. I think it was in the neighborhood of $30 a share for the common and $26 or so for the preferred, but if I am wrong —it was within the figure that we finally paid. I am not exactly sure of the numbers, because I haven't reviewed or looked at it since.

Q. Did you reach agreement at that time concerning the terms of the purchase of the Schmidt shares ?

A. A tentative agreement, yes, which was of course related to the purchase.

Q. What was the tentative agreement?

A. Tentative agreement, as I remember, was approximately 25 per cent down in cash and amortized by five year plan, unsecured, and an amount of warrants to be determined.

Q. You mean warrants to purchase common stock in National?

A. National, yes.

Q. Did you discuss with Mr. Schmidt the timing of your purchase of the shares—

Mr. Fiske: You are still talking about the meeting—

A. You are talking about the Palm Beach [60] meeting?

Q. Yes, the Palm Beach meeting?

A. I don't think we discussed the definitive date, but we discussed the urgency of making a decision and closing fairly rapidly, because he had an obligation to Hornblower & Weeks to cancel the secondary.

Q. Did you discuss or did Mr. Schmidt discuss with you the purchase of any other shares of the company, that is TSC?

A. At the time, yes, I think he mentioned that there may be some other shares that he may be able to acquire for us, at the time, from other stockholders.

Q. Did he say what other stockholders?

A. I don't recall.

Q. Did he say how many other shares of TSC?

A. I don't believe he did.

Q. Were you interested in acquiring other shares?

Mr. Stevens: Object.

A. As I remember, we told him we weren't interested in acquiring any additional shares from any other stockholder. We felt that it may have some legal consequences, and we would only be interested [61] in buying his holdings or his and his family's holdings.

Q. Did Mr. Schmidt ask you whether you intended to acquire all the other shares of the company, TSC?

A. I don't believe he did.

Q. Did he ask you whether you intended to acquire the company itself, TSC?

A. I don't believe he did.

Q. Did he ask you whether you intended to offer to purchase shares of other shareholders of TSC?

A. I just answered that question.

Q. Is your answer no?

A. My answer is that he did discuss if we were interested in acquiring some other blocks of other people, that he may have been friendly with or associated with, and we indicated "No."

Q. Now, I am asking you whether Mr. Schmidt asked you if you intended to make a tender offer or an offer generally?

A. You asked me that question, and I said, "No."

Q. Was anything else said by either you or Mr. Schmidt or anyone else at the meeting concerning the purchase of Mr. Schmidt's shares and those of his [62] family?

A. Say that again, I'm sorry?

(Thereupon, the question commencing at line 23, page 61 was read by the reporter.)

A. Nothing that I recall that was relevant or nothing that I recall generally.

Q. Was the matter of representation on the board of directors of TSC by persons holding positions with National Industries discussed?

A. I think it may have been discussed, but I think Mr. Schmidt declined to make any comment about it.

Q. Was the fact that an annual meeting of shareholders of TSC had been scheduled discussed?

A. I believe it probably was. The manner or the exact wording that it was discussed, I don't recall, but I get the feeling that it was discussed or certainly should have been.

Q. Didn't you discuss the fact that a meeting was about to be held on February 10, 1969 pursuant to notice which had already been mailed to the shareholders of TSC?

A. I am sure we probably—I don't recall the exact discussion. That's why I'm hesitant in trying to make a statement about it. I am sure it was [63] discussed, and it certainly—we were well aware of it, and of course this would indicate the urgency of completing the deal as readily as we could.

Q. What was the urgency?

A. The urgency that if we were able to buy and complete the block of stock and negotiate it, then in all probabilities we would want our directors or we would want to have the vote of the proxies so we could put our directors on the board, get our representation on the board. We would not, certainly, want to own twenty or thirty million dollars, whatever the million dollars were, twenty-two million dollars worth of stock without having representation.

Q. Did you discuss at that meeting means by which the transaction could be effected so that you could be in a position to control the voting of the Schmidt shares at that meeting which had been scheduled for February 10?

A. I really don't recall.

Q. Did you discuss with Mr. Schmidt the use of a proxy to vote his shares at that meeting?

A. I don't recall, but I would assume we probably talked about that, yes.

Q. Did you discuss with Mr. Schmidt possible postponement of that scheduled meeting of [64] shareholders of TSC?

A. I don't recall.

Q. Who was present at that meeting?

A. You want me to repeat?

Q. Other than Mr. Schmidt?

A. You want me to repeat it?

Q. No.

A. O.K.

Q. I want to finish the question—who was an owner of any of the shares which were in the Schmidt group of shares?

A. None that I know of.

Q. Was Mrs. Schmidt present?

A. No.

Q. Was Charles Schmidt, Jr. present?

A. No.

Mr. Stevens: I think he listed the people present.

Q. Am I correct, Mr. Yarmuth, that no member of the Charles Schmidt family was present except Mr. Schmidt?

A. It is my understanding and recollection that the only one on Schmidt's side was Schmidt, two brokers, and our people. If he had somebody in the basement, I don't know.

[65] Q. Did Mr. Schmidt tell you how many shares he was speaking for?

A. Yes. And I don't remember the exact number, but it was the Schmidt, and Schmidt Family Foundation, whatever number it was, children, whatever it was. What the number was, I don't recall.

Q. Did Mr. Schmidt tell you or did you believe that he was in a position to speak for the owners of those shares?

Mr. Fiske: Just a minute, I don't object to your asking him whether Mr. Schmidt said that. I object to the question to the extent that it asks Mr. Yarmuth what Mr. Smith may or may not have led him to believe. I have no objection to the conversation.

Q. Will you describe the conversation as best you recall it concerning Mr. Schmidt's authority to speak for the Schmidt family shares?

A. Well, of course authority wasn't discussed. Schmidt indicated to us that these are the shares that he was willing and wanting to sell, but encompassed the entire group of the Schmidt family and foundation. I don't know or remember whether he said he had authority or not authority to do it. He was just discussing selling the whole block.

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[86] Q. What do you recall discussing with Mr. Solomon?

A. Well, as Allen [Allan] is available to me, we probably discussed the information that we had and what we felt the stock was worth and whether or not we felt because of his corporate planning, would it philosophically fit into our company.

Q. What was your conclusion in that respect?

A. You mean our conclusion, as I indicated, was not nearly as bullish as we had been prior to what little investigation we

made, but by our actions our conclusion was that we'd go ahead and make the deal.

Q. So that you concluded that it did fit into the philosophy of the company, is that correct?

A. Right.

Q. Did you discuss potential purchase of the Schmidt shares with the executive committee and the board of directors of National?

A. I would guess we polled them, yes, by telephone.

Q. Was a meeting held on the subject?

A. I don't recall. I think there may have been a meeting by telephone rather than an actual [87] meeting in, you know, person.

Q. Mr. Yarmuth, we are discussing your investing some twenty-three million dollars in the stock of one company, and I want to be sure that I understand everything that National did preparatory to making that investment. You described all of the work that was done in that connection?

A. I described some of the work that I felt should have been done or I think should have been done but not necessarily that it was done, where we had the time to do it.

Q. Mr. Yarmuth, you indicated the net worth of National Industries, Inc. and the consolidated subsidiaries at December 31, 1968 as roughly sixty-six million dollars as shown in the proxy statement of November 12, 1969?

A. Right.

Mr. Stevens: '68 or '69?

Mr. Block: The figure was as of December 31, '68.

Mr. Fiske: What page is that?

Mr. Block: 61.

The Witness: That's probably right.

Q. And was slightly higher as of June 30, 1969, so that at or about the time that you were [88] discussing the purchase of the Schmidt shares, National and its consolidated subsidiaries had a net worth of some sixty-six million dollars, and you were

considering the purchase of twenty-three million dollars in the stock of TSC. For that reason, I wanted to be certain that I understood clearly all of the work that had been done by your staff preparatory to making that investment?

A. I think the thing for you to do, Mr. Block, is then interview each one of our staff to find out the extent of the work.

Q. Have you testified to your knowledge as to what has been done or had been done preparatory to making that investment?

A. Have I testified to that?

Q. As far as now.

A. My testimony is only from memory and from assumptions and from things I think should have been done, not from factual knowledge.

Q. Mr. Yarmuth, was one of the purposes of the analyses that were made of TSC during this period to determine whether TSC was attractive to National as an acquisition insofar as the entire company is concerned?

A. The purpose was to evaluate the block [89] of stock. At no time did we anticipate acquiring the balance of the stock, because we felt that this was a unique opportunity for us to purchase a block of stock that was available and take a look-see, and it also represented an opportunity for us as a financial investment, because we were then made available twenty some-odd million dollars worth of assets of stock, marketable assets, and gave a note for it. If we chose to sell that asset, then we could have made X number of dollars available to us on long term loan, allowing us to in effect do a secondary. So therefore we had a twofold purpose: One was to buy the stock with the unique terms that were available to us, then evaluate the company and then decide whether or not we felt like it was an opportunity for us to go further and acquire it or if we didn't, sell the stock and get a twenty million dollar secondary for us on a five year basis.

Q. Mr. Yarmuth, at the time that you purchased the Schmidt shares, didn't National have a clearly expressed policy of ac-

quiring the entire business of companies in which it acquired fractional interests wherever feasible?

A. No. Our policy is that of a company that treats each individual acquisition on the merits [90] of the purchase of the acquisition, and the way the thing is acquired. Some we acquire we specifically announce that we intend to acquire the remaining shares. Some, when we are not aware or not decided as to whether or not we are going to acquire the remaining shares, we so state. So we really have never had a definitive policy as to the way we go.

Q. Would you name a company with respect to which National announced an intention to acquire 100 per cent at the time that it acquired less than 100 per cent ownership?

A. If I understand your question, it is would I name a company that we intended to acquire a hundred per cent at the time of the purchase of the lesser block?

Q. No, that is not the question.

A. O.K.

Mr. Shure: Restate the question as given to the reporter.

(Thereupon, the question commencing at line 8, page 90 was read by the reporter.)

A. Yes, I can. Hawthorn-Melody [Hawthorn-Mellody].

Q. Will you name another company?

A. Another company?

Q. With respect to which the same thing [91] is true?

A. Same thing is true. I think we did the same thing, and I am saying this from memory, and I might not be correct, was Crescent Corporation. We immediately announced that we would make a bid for the remaining shares.

Q. Can you name another company with respect to which this is true?

A. I don't recall offhand.

Q. Mr. Yarmuth, in 1964, National acquired 66 per cent of the stock of Retail Centers for cash, is that right?

A. Correct. If your dates are correct.

Q. And National acquired additional stock in the open market in 1965 and 1966 in Retail Centers, is that true?

A. I believe so.

Q. And then in July of 1968, Retail Centers was merged into National, is that correct?

A. I believe so.

Q. In 1967, National acquired 55 per cent of the stock of Cott Corporation for cash, is that correct?

A. Right.

Q. And in July 1 of 1968, that corporation [92] was merged into National Industries?

A. If your dates are correct, that is true.

Q. And Crescent Corporation was purchased to the extent of 37 per cent of its stock for cash by National Industries in March of 1968, is that right?

A. If that's on the proxy statement, I am sure it's right.

Mr. Stevens: I think we are probably prepared to stipulate that the material in our proxy statements is accurate.

The Witness: Much more accurate than my memory.

Q. And that corporation was merged into National on July 1, 1968, is that correct?

A. If that so states, yes.

Q. Now, the investment in Hawthorn-Melody Inc. [Hawthorn-Mellody] which National made was 52 per cent stock purchase for cash on July of 1968?

A. Yes, assuming the date is correct.

Q. And that corporation was merged into National in October of 1968, is that correct?

A. I would assume, if that's what the proxy says.

Q. National purchased 59 per cent or [93] acquired a 59 per cent interest in Royal School Laboratories Inc.?

A. Yes.

Q. In the Crescent merger, is that correct?

A. If that's what it says.

Q. And that corporation also merged into National in October of 1968?

Mr. Stevens: I think it's November, Mr. Block.

Mr. Block: I stand corrected. It could be November in both cases. Is that correct, Mr. Yarmuth?

The Witness: Whatever the proxy statement stipulates, we will stipulate.

Q. Mr. Yarmuth, National Industries issued prospectus dated October 3, 1968 related to twenty-five million dollars worth of five and three-quarters per cent convertible subordinated debentures dated 1988, did it not?

A. Yes, it did.

Mr. Block: Mr. Reporter, I'd like a copy of that prospectus marked as Plaintiffs Exhibit 151 for identification.

(The prospectus above referred to was marked Plaintiffs Exhibit 151 for identification, and was returned to counsel.)

[94] Mr. Stevens: I will just state for the record, Mr. Block, that Plaintiffs Exhibit 151 for identification is a document which we supplied to the plaintiff, and it is a genuine document which in fact is what it purports to be.

Mr. Block: Thank you.

Q. Mr. Yarmuth, are you familiar with the contents of that prospectus which has been marked as Plaintiffs Exhibit 151?

A. I was familiar with it in 1968.

Q. Are the statements in that exhibit concerning National true?

A. To the best of my knowledge, they are true.

Q. And were they true at the time they were made?

A. To the best of my knowledge.

Q. On page 40 of that exhibit in the third paragraph contains the following statement: "National intends to continue to seek to acquire other businesses and product lines for cash or securities or both of kinds and types deemed advantageous by management." Is that statement true?

A. Yes.

Q. Was it true at the time it was made?

[95] A. Yes.

Q. Now, page 40 of Exhibit 151 also refers to the fact that there was pending at that time proposed mergers of National, of Hawthorn into National, and of Retail—I'm sorry—and of Royal—

A. School.

Q. —Laboratories into National, for approval by the shareholders of the respective companies, is that right?

A. I assume that's right.

Q. And did National issue a proxy statement with respect to those two proposed mergers?

A. I don't know. Oh, with respect—I'm sure we did. I don't know of any merger we didn't issue a proxy statement.

Q. I have here a copy of a letter to shareholders, a notice of special meeting and proxy statement, all dated September 27, 1968 with reference to the merger between National Industries Inc. and Hawthorn-Melody Inc. [Hawthorn-Mellody], and between National Industries Inc. and Royal School Laboratories Inc., together with a book entitled Appendices to Proxy Statements of National Industries Inc., Hawthorn-Melody Inc. [Hawthorn-Mellody], and Royal School Laboratory Inc. I would like to have the reporter mark these books as Exhibits 152 [96] for identification and 152-A.

(The documents above referred to were marked Plaintiffs Exhibits 152 and 152-A for identification, and were returned to counsel.)

Mr. Stevens: I will make the same statement about these two exhibits.

Mr. Shure: The same statement being that they were given to us by you.

Mr. Stevens: Through me, if not directly by me.

Mr. Shure: And they are true and correct copies?

Mr. Stevens: Correct.

Q. Mr. Yarmuth, I hand you the documents which have been marked as Exhibit 152 and 152-A, and ask you if you are familiar with those documents and the contents thereof?

A. At one time, I am sure I was.

Q. Are the statements in those documents concerning National true?

A. To the best of my knowledge.

Q. Were they true at the time they were made?

A. To the best of my knowledge.

Q. Now, this September 27, 1968 proxy [97] statement relates to a proposed merger of Hawthorn-Melody [Hawthorn-Mellody] into National Industries Inc., does it not?

A. You are reading it. I haven't had time to review it, so I will assume what you say is correct. I can't even see it.

Q. Take all the time you need.

A. From the title, I see it says National has entered into agreements and plans of merger with Hawthorn-Melody [Hawthorn-Mellody] and Royal School Laboratories Inc. I stipulated to the best of my knowledge this is true.

Q. I take it your answer is yes, is that right?

A. To the best of my knowledge.

Q. Now, on page 3 of Exhibit 152 with respect to the proposed Hawthorn merger, the following statement is made: "The board of directors of National believes that the merger is consistent with its program of acquiring complete ownership of businesses wherever feasible." Is that statement contained there?

A. I don't see it, but—where?

Q. (Counsel points.)

A. "Acquiring complete ownership of businesses wherever feasible."

Q. The statement is there, is it not?

A. I am sure that's true.

[98] Q. It is true?

A. Well, the wording.

Q. I am asking you first.

A. You are playing with words now.

Q. All I asked you, Mr. Yarmuth, is whether this statement appearing in this proxy statement—

A. That statement appears in this proxy statement, yes.

Q. And I now ask you if that statement is true?

A. Generally.

Q. Was it true at the time it was made?

A. Generally.

Q. Mr. Yarmuth, page 5 of the same proxy statement referring to the proposed Royal merger contains the following statement, does it not: "The board of directors of National believes that the merger is consistent with its program of acquiring complete ownership of business wherever feasible"?

A. The same statement as before, and it is generally true.

Q. And was it true when it was made?

A. Of course.

Q. Mr. Yarmuth, with respect to the merger of Retail Centers, Cott Corporation, and Crescent [99] Corporation into National in July of 1968, did National issue a proxy statement?

A. I am sure they did.

Mr. Block: Mr. Reporter, I have here a printed book containing letter to shareholders of National Industries Inc., notice of deferred annual meeting of shareholders, and proxy statement, all dated May 17, 1968, and in addition a booklet entitled Appendices to Proxy Statement of National Industries Inc., Retail Centers of America, Inc., Cott Corporation and Crescent Corporation, and ask that you mark these as Plaintiffs Exhibits Numbers 153 and 153-A respectively for identification.

(The documents above referred to were marked Plaintiffs Exhibits 153 and 153-A for identification and were returned to counsel.)

Mr. Block: Mr. Stevens, have we the same stipulation concerning the authenticity of those two documents?

Mr. Stevens: Dated May 17, 1968, right.

Q. Mr. Yarmuth, are you familiar with the contents of Exhibits 153 and 153-A?

A. In the same way as I was with the others, yes.

Q. Are the statements contained in there [100] with respect to National true?

A. The best of my knowledge.

Q. Were they true when they were made?

A. To the best of my knowledge.

Q. On page 5 of Exhibit 153 with respect to the Retail Centers proposed merger, the following statement appears, does it not: "The board of directors of National believes that the merger is consistent with its program of acquiring complete ownership of businesses wherever feasible." Is that statement true?

A. To the best of my knowledge.

Q. Was it true when it was made?

A. Yes.

Q. Page 6 of the same exhibit refers to the proposed Cott merger and contains the following statement, does it not: "The board of directors of National believes that the merger is consistent with its program of acquiring complete ownership of businesses wherever feasible."

A. True, true.

Q. Is that statement true?

A. Was to the best of my knowledge and is to the best of my knowledge.

Q. On page 8 of the same exhibit, with [101] respect to the proposed Crescent merger, the following statement appears, does it not: "The board of directors of National believes that the merger is consistent with its program of acquiring complete ownership of businesses wherever feasible"?

A. Same.

Q. And that statement is true now and was true when it was made, is that correct?

A. To the best of my knowledge.

Mr. Stevens: Mr. Reporter, let me make a statement for the record that subject to verification, and counsel will work this out, Mr. Block has handed me Xerox copies of a group of papers which begin with the number W62 I believe and run on for a number of pages which come out, apparently come out of a volume, the original of which has an index which has subtitles of "Documents Executed Prior to Closing, Closing Documents, Brokers' Letter," and the second page also goes all the way down to stock purchase agreement dated October 14, 1969 between National and Peterson. I take it that these papers come out of paragraph 23 of that index.

Mr. Block: Which is entitled—

Mr. Stevens: Work papers.

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IN THE UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

[Title Omitted in Printing.]

The continued depositions of STANLEY R. YARMUTH, called by the plaintiff for examination, pursuant to agreement and pursuant to the Rules of Civil Procedure for the United States District Courts pertaining to the taking of depositions for the purpose of discovery, taken before Jean Korinko Sweeney, a notary public and certified shorthand reporter within and for the County of Cook and State of Illinois, taken at Suite 1500, 39 South LaSalle Street, Chicago, Illinois, on Friday, September 10, 1971, commencing at the hour of 10:00 o'clock a.m.

* * * * *

[232] The Witness: You want me to answer the question?

Mr. Rothschild: What is the question?

The Witness: That is all.

Mr. Block: Restate the question.

(Question read.)

The Witness: The question, as I understand it, is subsequent to January 16, 1969?

Mr. Block: That is right.

The Witness: After the meeting at Boca Raton I don't believe I had but one or two conversations with Mr. Schmidt subsequent to that meeting, and I am sure that—well, I don't remember specifically discussing board representation, but I certainly would have wanted more representation in purchasing a block of stock that large and making an investment of that size in the company.

By Mr. Block:

Q. Do you recall attending a meeting in Chicago on or about February 5th at which Mr. Simonelli and others were

also present, as were various members of the Board of Directors of TSC Industries?

A. Was it a Board of Directors of TSC [233] Industries meeting? At TSC Industries?

Q. I believe one was.

A. Their office?

Q. I believe one was held there.

A. If that was the day, yes, I recall that meeting, yes, sir.

Q. Do you recall at that time a discussion concerning National's desire for representation on the Board of TSC Industries?

A. Yes, sir.

Q. Now, what took place at that time concerning—

A. At that time, as I recall, we requested approximately six seats out of the 11. My number may not be exact. But we requested the majority of seats on the Board. We were denied that. We offered several names. I believe that four people were agreed upon out of the eleven seats.

Q. For the record, I have given you a copy of Exhibit No. 8, which is the March 7, 1969, notice of the adjourned annual meeting of stockholders of TSC Industries. Does a review of the names proposed on the slate of directors in that proxy statement refresh your recollection?

A. Refresh my recollection of what, Mr. Block?

[234] Q. Of the number of directors which were proposed and those which were directly National Industries nominees?

A. There are ten directors here as I count, and I see one, two, three, four that are nominees of National.

Q. Do you recall any other discussion concerning National's representation on the Board of TSC Industries?

A. Yes. We asked to nominate two other people and were refused.

Q. Who were those two?

A. The two people as I remember were Senator Marlow Cook, a United States Senator, and Norman Stepelton, who was at the time president of National Tea Company.

Q. Wasn't it correct, Mr. Yarmuth, that Mr. Stepelton himself declined that proposed nomination?

Mr. Rothschild: I am going to object to this line of questioning. I have no objection to the particular question, the statement is true, but this isn't proper discovery at this point in the litigation. You have gotten all this information from other witnesses. There [235] is no dispute as to this. This is discovery. You have got Stanley Yarmuth here. If you have something you want to discover from him, something you haven't got from somebody else, let's get to it. There is no question about it, Marlow Cook they didn't want. Stepelton decided he couldn't serve. We have been over it and over it.

By Mr. Block:

Q. I take it your answer is yes?

A. Not exactly. Stepelton agreed to serve, and then after refused, prior to our talking to them, refused. Stepelton had decided that he had stores, grocery stores in the same shopping centers, and thought it wise not to. So therefore he really wasn't turned out. He accepted and then— We had asked Stepelton prior to suggesting his name, and he had agreed.

Q. At that time was there any discussion as to the persons who would serve as officers of TSC Industries?

A. No, sir. I want to say there was a great deal of—

Mr. Rothschild: Don't say anything.

[236] There is no question.

The Witness: O.K.

By Mr. Block:

Q. Now, the adjourned annual meeting of the shareholders of TSC Industries was held on March 31, 1969, at which time the slate of directors proposed in the March 7th notice and proxy statement were elected. Up to that time, Mr. Yarmuth, did you have any conversation with anyone concerning the management or proposed management of TSC Industries?

A. Between what dates?

Q. Between the closing the Schmidt transaction now and March 31st.

Mr. Rothschild: I would like you to clarify "management." Do you mean operating management or do you mean the directors? If you mean something other than directors, I think you should say it. You have been talking about the directors.

By Mr. Block:

Q. I am referring to officers and persons who would become officers of the TSC Industries.

A. The only person, the only people that I talked with were Dick Schaefer and Sam Sharfman.

[237] Q. What was the conversation you had with Mr. Schaefer?

A. Well, we were concerned, of course, with Mr. Schaefer staying with the company and continuing his management, and with Sharfman also.

Q. Yes. But what were your conversations insofar as you had them with Mr. Schaefer.

A. Well, with Mr. Schaefer we would hope that he would remain as chief executive officer; and Sharfman would remain as head of the Community Division, and asked for reassurances.

Q. With respect to Mr. Schaefer, can you recall the contents of any conversations you had with him?

A. Not verbatim, no.

Q. Can you recall generally, other than what you have already testified?

A. Generally, that is what our concern was.

Q. Was there a discussion as to what his office would be?

A. His office would be chief executive officer.

Q. Was there discussion as to what his compensation would be?

A. I don't recall any conversations about [238] compensation at the time.

Mr. Rothschild: The question is whether this was before the March 31st meeting.

Mr. Spitalli: That's right.

Mr. Block: Yes, up to that time.

Mr. Rothschild: You understand that, this conversation is prior to March 31st.

Mr. Block: Let the record show that he indicated yes to Mr. Rothschild's question.

By Mr. Block:

Q. Was there any discussion with Mr. Schaefer concerning additional stock options?

A. I don't recall any.

Q. Now, can you recall the content of your conversations with Mr. Sam Sharfman?

A. Basically our concern was of course with the Community Division, with Sharfman, and the continuing of the operation, and questioning him about some of the problems that were brought up by Dave King in the Community Division.

Q. Was there a discussion with Mr. Sharfman concerning what his office would be?

A. I don't recall anything other than the head of the Community Division.

[239] Q. Do you recall any conversation with him concerning what his compensation would be?

A. No, sir.

Q. Other than the conversations which you have testified to, do you recall any other conversations with anyone up to the March 31st meeting?

A. No, sir.

Q. Now, to refresh your recollection and orient you for a question, Mr. Yarmuth, I will point out that at the time that you first met with Mr. Schmidt there was on file with the SEC a preliminary prospectus with regard to a proposed public offering of common shares of TSC Industries.

I will also point out that with the execution of the Schmidt agreement on January 30th or 31st of 1969, that proposed public offering was the subject of conversation between Mr.

Schmidt and Mr. Noyes of the Hemphill firm. Specifically, that Mr. Schmidt's shares that would otherwise have been a part of that public offering had been made the subject of a transaction with National.

Now, I'd like to show you a document which has previously been marked as Exhibit 240, and which is a copy of a memorandum of January 31, 1969, from [240] Mr. Weinstein to you with respect to the TSC shares owned by Louis Terry, that were also to be a part of the original preliminary prospectus which was filed at the public offering which was proposed.

I direct your attention particularly to the handwritten notation on the bottom of that sheet which says, "Tell him we intend to continue with the secondary and will go through with his sale." The initials I believe are S. R. Y. Is that your handwriting in the bottom corner of the exhibit, Mr. Yarmuth?

A. Yes.

Q. Do you recall discussing the subject matter of the Terry sale with Mr. Weinstein?

A. Obviously there was no discussion. It was just a memo and the written memo back.

Q. Do you recall discussing that subject with anyone else—

A. No.

Q. —at or about the time you made that notation?

A. No, sir.

Q. Well, then, I take it that you received this memorandum from Mr. Weinstein at or about that time, is that right?

[241] A. I presume that is correct.

Q. And that you wrote your notation in answer thereto, is that right?

A. Right.

Q. And you did not at that time discuss the situation with anyone else?

A. I did not, that I remember.

Q. Mr. Yarmuth, when did you first take any action with respect to the acquisition by National of any further interest in TSC Industries following the acquisition of the Schmidt shares?

A. When did I take any action, in what respect?

Q. In any respect?

A. Well, of course we acted as directors when we were elected to be directors.

Mr. Rothschild: I don't think you heard the question.

Read the question.

Mr. Spitalli: I move the witness' answer be stricken as not responsive.

(Record read.)

By the Witness:

A. I really don't understand the question. Could you be a little more implicit.

* * * * *

[247] The Witness: Mr. McClinton's date or your so stating Mr. McClinton's date, does not refresh my recollection. My recollection is as I previously stated, and the word I used was specifically. It doesn't help me at all. I cannot testify for Mr. McClinton, I am testifying for myself. My own recollection, which I am very specific about.

By Mr. Block:

Q. All right. What was the action which you took at that time?

A. At that time we—I had my staff, whoever it may have been at the time, I decided that maybe we should consider drawing up several propositions and formulating some means of acquiring the remaining stock of TSC. Of course we were well aware of the fact that when you acquire the remaining shares you have to acquire it to the advantage of the outstanding stockholders of the company, and we were trying to formulate various ways in which to give the TSC stockholders more than they had at the time, otherwise we couldn't have acquired the stock.

* * * * *

[258] (Question read.)

By the Witness:

A. My answer would be no. It is a great time lapse—

Mr. Rothschild: You have answered.

By Mr. Block:

Q. During your discussions with Mr. Schmidt did he at any time request that you agree to pay the same amount that was paid to the Schmidt defendants, either to the shareholders of TSC or to TSC itself, in the event you attempted to acquire shares of TSC, or to acquire the assets of TSC?

Mr. Spitalli: I object to the form of the question. It assumes facts not in evidence.

The Witness: Repeat the question.

(Question read.)

By the Witness:

A. No.

UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division at Chicago

[Title omitted in printing.]

DEPOSITION OF STANLEY YARMUTH
TAKEN BY PLAINTIFF

Louisville, Kentucky
December 16 and 17, 1971

* * * * *

[55] A. Yes, they did.

Q. Mr. Yarmuth, were you aware of the fact that during 1968 Madison Fund made purchases of common stock of National?

A. Yes.

Q. Were you aware of those purchases during 1968?

A. I was aware that they had made purchases in 1968, yes.

Q. How did you learn that the purchases were made by Madison Fund during 1968?

A. Well, occasionally Merkle would say to me "You better be a good boy and operate this company well, because I own 50 or 75" or whatever amount of shares that they have or round numbers.

Q. As I understand you, Mr. Merkle told you of purchases of National's common stock by Madison Fund during 1968, is that right?

A. Well, not specifically each purchase, but occasionally he referred to the fact that he was a stockholder, yes. We can also see it on the transfer sheets.

(Discussion off the record.)

Q. Now, what transfer sheets are you referring to, Mr. Yarmuth?

[56] A. Well, of course, the bank supplies the Company with transfer sheets on a periodic basis. The transfer sheets are sheets that show who bought and who sold stock.

Q. And are those transfer sheets provided on a daily basis, Mr. Yarmuth?

A. No. I don't believe so. I really don't know, but I don't believe so, but I certainly don't review them.

Q. Those sheets that you are referring to were provided by your transfer agents during 1968 and 1969, is that right?

A. I am sure they were, yes sir.

Q. Are those sheets delivered directly to you, Mr. Yarmuth, or someone else in the Company here?

A. No. They are not delivered to me. I don't know, although I would guess Allan Soloman, but I am not sure.

Q. And were you aware during 1968 of the purchases by National of its common stock during that year?

A. Yes. '68?

Q. Yes.

A. You had two sheets there.

NATIONAL INDUSTRIES, INC. **TSC INDUSTRIES, INC.**

November 12, 1969

To Our Shareholders:

The Boards of Directors of National Industries, Inc. ("National") and TSC Industries, Inc. ("TSC") have approved the sale of substantially all of the assets of TSC to a subsidiary of National ("Transferee") in exchange for shares of National's $1.25 Series B Cumulative Convertible Preferred Stock (paying an annual preferred dividend of $1.25 per share) and National Warrants, Transferee's assumption of substantially all of TSC's liabilities and certain undertakings by National and Transferee. The attached proxy materials detail the proposal, which requires the approval of the shareholders of both TSC and National.

Management urges you to mark your proxy FOR this purchase of TSC assets by National and FOR all other action to be taken at the meeting.

The votes of National shareholders will be counted at a meeting of National shareholders to be held on December 5, 1969, in Louisville, Kentucky. The votes of TSC stockholders will be counted at a meeting of TSC stockholders to be held on December 5, 1969, in Chicago, Illinois.

The Directors of both companies are of the opinion that this acquisition is in the best interests of the shareholders of both National and TSC.

We urge you therefore to sign, date and mail the enclosed proxy in the enclosed, self-addressed envelope as soon as possible after you have studied the attached proxy statement.

Sincerely,

NATIONAL INDUSTRIES, INC.

STANLEY R. YARMUTH
President

TSC INDUSTRIES, INC.

RICHARD H. SCHAEFER
President

TSC INDUSTRIES, INC.

Notice of Special Meeting of Stockholders

A special meeting of stockholders of TSC Industries, Inc. (the "Company") will be held in Room 1848, La Salle Bank Building, 135 South La Salle Street, Chicago, Illinois, on Friday, December 5, 1969, at 10:00 a.m., Chicago time, for the following purposes:

(1) To consider and vote upon approval and adoption of an amendment to the Certificate of Incorporation, as amended, of the Company providing for an amendment to and modification of the liquidation and conversion rights of holders of Preferred Stock and holders of $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1 of the Company as described in the accompanying Proxy Statement;

(2) If the proposal described in paragraph 1 of this Notice is adopted, to consider and vote upon approval and adoption of the Plan of Complete Liquidation of the Company providing for the distribution of assets and complete liquidation of the Company as described in the accompanying Proxy Statement and the dissolution of the Company in accordance with such Plan enclosed as Exhibit C thereto;

(3) If the proposal set forth in paragraph 2 of this Notice is adopted, to consider and vote upon approval and adoption of an Agreement, dated as of October 16, 1969 (the "Agreement"), providing for the sale of substantially all the assets, properties and business of the Company to a subsidiary of National Industries, Inc. ("Transferee") in exchange for shares of National's $1.25 Series B Cumulative Convertible Preferred Stock and National Warrants, the assumption by Transferee of substantially all of the liabilities of the Company and certain undertakings by National and Transferee, all as described in the accompanying Proxy Statement and the Agreement enclosed as Exhibit B thereto;

(4) If the proposal set forth in paragraph 3 of this Notice is adopted, to consider and vote upon approval and adoption of an amendment to the Certificate of Incorporation, as amended, of the Company to change its name, as required by the Agreement, to TS Liquidating Company, concurrently with the proposed sale of assets; and

(5) To transact such other business as may properly come before the meeting.

Although each of the above proposals will be submitted to a separate vote, such proposals are interrelated and none of the proposals shall be deemed to have been adopted unless all are adopted by the requisite vote.

Stock transfer books of the Company will not be closed but, as determined by the Board of Directors, only stockholders of record as of the close of business on October 24, 1969, are entitled to notice of and to vote at the meeting. A complete list of the stockholders entitled to vote at the meeting will be available for inspection at the office of the Company, 4747 N. Ravenswood Avenue, Chicago, Illinois.

By order of the Board of Directors,

Chicago, Illinois
November 12, 1969

LAWRENCE W. SCHWEIK, *Secretary*

IF YOU DO NOT INTEND TO BE PRESENT AT THE MEETING, PLEASE FILL IN, SIGN AND RETURN THE PROXY IN THE ENCLOSED ENVELOPE WHICH REQUIRES NO POSTAGE. IF YOU ATTEND THE MEETING, YOU WILL BE ENTITLED TO VOTE IN PERSON.

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SPECIAL MEETING OF SHAREHOLDERS
of
NATIONAL INDUSTRIES, INC.
December 5, 1969

SPECIAL MEETING OF STOCKHOLDERS
of
TSC INDUSTRIES, INC.
December 5, 1969

Proxy Statement

November 12, 1969

Special Meetings of Shareholders of National Industries, Inc., a Kentucky corporation ("National"), and TSC Industries, Inc., a Delaware corporation ("TSC"), will be held on December 5, 1969, for the purposes set forth in their respective notices and in this Proxy Statement. The accompanying form of Proxy is solicited on behalf of the respective managements of National and TSC in connection with each meeting and any adjournments thereof.

Proxies in the accompanying form which are properly executed, duly returned to management and not revoked will be voted in accordance with the instructions contained therein. If no instructions are given with respect to any particular proposal to be acted upon, Proxies will be voted in favor thereof. Each Proxy given by a shareholder may be revoked by him at any time prior to its exercise, but in the case of National, revocation is not effective until the Secretary of National receives notice of the revocation.

The outstanding voting securities of National are its $.60 Series A Cumulative Convertible Preferred Stock ("National Series A Preferred Stock"), its $1.25 Series B Cumulative Convertible Preferred Stock ("National Series B Preferred Stock"), and its Common Stock. Each share of stock (regardless of class) entitles the holder to one vote. Only National shareholders of record at the close of business on October 24, 1969 are entitled to vote at the National meeting or any adjournments thereof. As of that date there were outstanding 137,829 shares of National Series A Preferred Stock, 181,320 shares of National Series B Preferred Stock, and 6,614,041 shares of National Common Stock (not including treasury shares). So far as is known to management, on October 24, 1969 no person owned of record or beneficially more than 10% of the outstanding voting shares of National.

The outstanding voting securities of TSC are its $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1 ("TSC Series 1 Preferred Stock"), and its Common Stock. Each share of stock (regardless of class) entitles the holder to one vote. Only TSC stockholders of record at the close of business on October 24, 1969 are entitled to vote at the TSC meeting or any adjournments thereof. As of that date there were outstanding 951,513 shares of TSC Series 1 Preferred Stock and 1,852,603 shares of TSC Common Stock. On October 24, 1969, National was the beneficial owner of 439,675 shares of TSC Series 1 Preferred Stock and 519,733 shares of TSC Common Stock, equivalent to approximately 46% of the TSC Series 1 Preferred Stock, 28% of the TSC Common Stock, and approximately 34% of the total number of shares of both classes. National intends to vote its shares in favor

of the proposals to be voted upon by the TSC stockholders. Except for the holdings by National, so far as is known to the management of TSC, no person owned of record or beneficially more than 10% of the outstanding voting shares of TSC.

Information herein contained with respect to each corporation has been supplied by such corporation and is included in this Proxy Statement by each corporation in reliance upon the corporation which supplied such information.

PURPOSES OF MEETINGS

National

A special meeting of the National shareholders has been called for the purpose of considering and acting upon the following matters:

(1) Approval and adoption of an amendment to the Restated Articles of Incorporation of National increasing the number of authorized shares of Common Stock from 12,000,000 shares to 20,000,000 shares. The adoption of this proposal will require the affirmative vote of the holders of at least two-thirds of the shares of National Common Stock and both series of National Preferred Stock voting together as a single class. Should this proposal fail to receive the required affirmative vote, the acquisition by National, through a subsidiary of National ("Transferee") to be organized for such purpose, of the assets of TSC cannot be consummated since National must reserve shares of National Common Stock in excess of its present authorized shares, to provide for the conversion of the shares of National Series B Preferred Stock, the exercise of the National Warrants to be issued in such acquisition, and the exercise of certain restricted and qualified stock options of TSC to be assumed by National in connection with the acquisition. A copy of the proposed amendment to the Restated Articles of Incorporation of National is enclosed with this Proxy Statement as Exhibit A.

(2) Approval and adoption of an Agreement, dated as of October 16, 1969 (the "Agreement"), between National and TSC providing for the purchase of substantially all the assets, properties and business of TSC by Transferee in exchange for shares of National Series B Preferred Stock, National Warrants expiring October 31, 1978 to purchase one share of National Common Stock at a price of $21.40 per share ("National Warrants"), the assumption by Transferee of substantially all of the TSC liabilities and certain undertakings by National and Transferee, all as hereinafter more fully described. Since the number of shares of National Common Stock to be reserved for issuance to the TSC stockholders upon the conversion of the National Series B Preferred Stock and upon the exercise of the National Warrants would result in an increase of more than 20% in the number of National's outstanding Common Stock if such securities were converted and exercised, the rules of the New York Stock Exchange require approval of this acquisition by an affirmative vote of the holders of at least a majority of the shares of National Common Stock and both series of National Preferred Stock, all voting together as a single class. If the proposal to increase National's authorized Common Stock is not approved, no vote will be taken at this meeting on the proposal to acquire the assets of TSC. A copy of the Agreement is enclosed with this Proxy Statement as Exhibit B.

TSC

A special meeting of TSC stockholders has been called for the purpose of considering and acting upon the following matters:

(1) Approval and adoption of an amendment to the Certificate of Incorporation, as amended, of TSC modifying and amending the liquidation and conversion rights of the holders of TSC Preferred Stock and TSC Series 1 Preferred Stock, such modifications and amendments being more fully described under the caption "Amendment to TSC's Certificate of Incorporation" and Exhibit D enclosed with this Proxy Statement;

(2) Approval and adoption of a plan of complete liquidation (the "Plan of Complete Liquidation") providing for the distribution of the assets of TSC to its stockholders in complete cancellation and redemption of their TSC stock and liquidation of TSC prior to November 30, 1970 and the approval of the appointment of an Exchange Agent and Trustee for the stockholders of TSC;

(3) Approval and adoption of an Agreement, dated as of October 16, 1969 (the "Agreement"), between National and TSC, providing for the sale of substantially all of the assets, properties and business of TSC to Transferee in exchange for shares of National's Series B Preferred Stock, National Warrants, the assumption by Transferee of substantially all of the liabilities of TSC, and certain undertakings of National and Transferee; and

(4) Approval and adoption of an amendment to the Certificate of Incorporation, as amended, of TSC changing the name of TSC to "TS Liquidating Company."

The adoption of proposal (1) above will require the affirmative vote of (i) the holders of at least two-thirds of the shares of TSC Series 1 Preferred Stock voting as a single class, and (ii) the holders of at least a majority of the TSC Common Stock voting as a single class. The adoption of proposals (2), (3) and (4) will, in each case, require the approval of the holders of at least a majority of the shares of TSC Series 1 Preferred Stock and TSC Common Stock voting together as a class.

Each of the above proposals will be considered and voted upon in the order hereinabove set forth. Since the adoption of each of such proposals is interrelated, failure to approve any of these proposals will prevent consummation of the transactions contemplated by the Agreement. None of the proposed amendments to TSC's Certificate of Incorporation shall be deemed to have been adopted unless all of the proposals hereinabove set forth are adopted by the requisite vote.

The Agreement and the Plan of Complete Liquidation are enclosed with this Proxy Statement as Exhibits B and C, respectively.

Other Matters

The management of each corporation knows of no matters other than those listed in its Notice of Meeting which are to be brought before its meeting. However, if any other matter, not now known, properly comes before such meeting, the persons named in the enclosed form of Proxy will vote such Proxy in accordance with their best judgment on such matters.

AMENDMENT TO NATIONAL'S RESTATED ARTICLES OF INCORPORATION

The proposed amendment of National's Restated Articles of Incorporation will increase the authorized Common Stock of National from 12,000,000 to 20,000,000 shares. This increase is necessary to permit the issuance of Common Stock upon conversion or exercise of securities to be issued and stock options to be assumed in connection with the TSC acquisition. For a description of the powers, preferences and rights, and the qualifications, limitations and restrictions of the National Common Stock, see "Description of Capital Stock" herein, and Appendix 1 to the Agreement enclosed herewith as Exhibit B.

Assuming the consummation of the TSC acquisition and the issuance of the maximum number of shares of Common Stock upon the exercise of outstanding options and warrants, as well as upon the conversion of all convertible debentures, all shares of National Series A and B Preferred Stock now outstanding and issuable upon consummation of the TSC acquisition, and the employee stock options to be assumed in connection therewith, it would be necessary to increase the authorized number of shares of National Common Stock from 12,000,000 to approximately 13,000,000. Insofar as the additional authorized shares are not needed for the foregoing purposes, they will provide sufficient authorized but unissued shares for possible future acquisitions, stock dividends and other corporate purposes without the necessity of further shareholder action. Accordingly, approval of the

amendment of the Restated Articles of Incorporation would permit the Board of Directors of National to issue such additional shares without further approval of shareholders, except as may be required by law or the applicable rules of any stock exchange on which the Common Stock is listed.

Except for the TSC acquisition, no specific plans or intentions have been formulated for the issuance of additional shares of any class. While National is constantly reviewing the possible acquisition of other companies and is currently having preliminary discussions with several such companies, at the present time there is no agreement, in principle or otherwise, on the terms of any such acquisition.

AMENDMENT TO TSC'S CERTIFICATE OF INCORPORATION

At a meeting held on October 16, 1969, the Board of Directors of TSC approved, for submission to the stockholders, proposed amendments to TSC's Certificate of Incorporation providing for a change of TSC's name to TS Liquidating Company, and modifying the liquidation and conversion rights of holders of TSC Series 1 Preferred Stock. In voting on the proposed amendments, stockholders shall be entitled to one vote for each share of Common Stock, and one vote for each share of TSC Series 1 Preferred Stock held by them. Each of the proposed amendments shall be submitted to a separate vote of stockholders as hereinabove described. However, the adoption of each such amendment shall be deemed effective only if all the proposals described under the caption "Purposes of Meetings—TSC" are adopted, and the transactions contemplated by the Agreement are consummated.

The following summary of the proposed amendments does not purport to be a complete statement of the terms thereof and is qualified by reference to the full text of the amendments set forth in Exhibit D enclosed herewith.

Change of Corporate Name

Performance of National's obligations under the Agreement is conditioned in part upon TSC adopting an amendment to its Certificate of Incorporation, changing its name to one dissimilar to its present name. For this purpose the Board of Directors of TSC has selected the name "TS Liquidating Company." It is contemplated that the wholly owned subsidiary of National formed for the purpose of acquiring TSC's assets under the Agreement will simultaneous with the amendments of TSC's Certificate of Incorporation adopt TSC's name.

Change of Liquidation Rights

The present Certificate of Incorporation provides for a class of preferred stock issuable in series, and authorizes the Board of Directors, within certain limits, to establish the designation, rights and preferences of each series. With respect to liquidation rights, the present Certificate of Incorporation provides that holders of preferred stock of any series are entitled to receive any preferential amount, including the amount of dividend arrearages, if any, fixed by the resolution of the Board of Directors before any distribution can be made to the holders of junior securities. After payment of the preferential amount, preferred stockholders may participate in any further distributions to the extent provided for in the resolutions establishing each series. In establishing the TSC Series 1 Preferred Stock, the Board of Directors provided that on liquidation holders of TSC Series 1 Preferred Stock shall first be entitled to receive any dividend arrearages before any distributions are made to the holders of junior securities. Thereafter, TSC Series 1 Preferred stockholders and common stockholders are to share ratably in all liquidating distributions. For such purpose each share of TSC Series 1 Preferred Stock is deemed to be the equivalent of the number of shares of common stock into which it is convertible at the then applicable conversion rate. The conversion rate presently in effect provides for the issuance of .75 share of common stock for each share of the TSC Series 1 Preferred Stock converted.

It is proposed to amend the Certificate of Incorporation and the provisions of the TSC Series 1 Preferred Stock to provide that upon liquidation the holders of the TSC Series 1 Preferred Stock shall receive .6 share of National Series B Preferred Stock and one National Warrant. For a description of the National Capital Stock, the National Series B Preferred Stock and National Warrant, see "Description of Capital Stock" and "Description of Warrants of National" herein and Appendices 1, 2 and 3 to Exhibit B enclosed herewith. The purpose of this change is to conform the liquidation provisions of the TSC Series 1 Preferred Stock to the payment formula set forth in the Agreement.

After consummation of the transaction between TSC and National, TSC's assets will consist solely of the National securities provided for under the Agreement plus cash in an amount necessary to pay certain expenses. If the proposed amendment is adopted the holders of TSC Series 1 Preferred Stock will receive the securities in the amount set forth above, and holders of TSC Common Stock will receive .5 share of National Series B Preferred Stock and 1.5 National Warrants for each share of Common Stock.

Assuming that the aggregate number of National securities were delivered to TSC as provided by the Agreement and that such securities were distributed by TSC to its stockholders pursuant to the present liquidation provisions in the TSC Certificate of Incorporation, the National securities would be distributed as follows: (i) TSC Series 1 Preferred Stock would receive .44 share National Series B Preferred and 1.09 National Warrants per share, and (ii) TSC Common Stock would receive .58 share of National Series B Preferred Stock and 1.45 National Warrants per share. If approved, the modified liquidation rights will apply only with respect to liquidations made pursuant to a voluntary plan of complete liquidation adopted by the Board of Directors of TSC on or before December 1, 1969. In any other liquidation, holders of TSC Series 1 Preferred Stock shall have the same liquidation rights they now have.

Change of Conversion Rights

The proposed amendments also provide that the conversion rights of TSC Series 1 Preferred Stock shall terminate as of the close of business on the last regular business day prior to the date on which any merger, consolidation or sale, lease or exchange of all or substantially all of the assets of TSC shall be consummated whereby TSC shall cease doing business as a separate entity. Since the transaction with National is scheduled to close on December 6, 1969, if the amendment is adopted, conversion rights will be terminated as of the close of business on the date of the meeting of stockholders. Public announcement will be made of any change in the closing date. This amendment is necessary in order to fix the number of TSC Series 1 Preferred Stock and the number of shares of TSC Common Stock outstanding for purposes of determining the amount of National securities to be delivered at Closing.

Vote Required

Delaware law requires that if any amendment to the Certificate of Incorporation adversely affects the powers, preferences or special rights of any class of stock, the holders of the outstanding shares of that class of stock shall be entitled to vote as a class on that amendment. The Certificate of Incorporation of TSC requires the affirmative vote of at least two-thirds of the outstanding Series 1 Preferred Stock for passage of any such amendment. Although management does not believe that the modification of the liquidation and conversion rights will have an adverse effect upon the holders of TSC Series 1 Preferred Stock, the proposed amendments will be submitted to stockholders in a single proposal to be voted upon by the holders of both Common Stock and TSC Series 1 Preferred Stock, each voting as a class. The proposal will be approved upon a favorable vote of a majority of the outstanding shares of common stock, and two-thirds of the outstanding shares of TSC Series 1 Preferred Stock.

The proposed amendment of the corporate name must be approved by a favorable vote of a majority of the outstanding shares of Series 1 Preferred Stock and Common Stock voting together as a single class.

PROPOSED AGREEMENT TO SELL TSC'S ASSETS TO NATIONAL AND LIQUIDATION AND DISSOLUTION OF TSC

Boards of Directors Approval

The Boards of Directors of National and TSC have approved the Agreement and believe that the transactions contemplated thereby are in the best interests of the shareholders of both corporations, who will benefit through the diversified activities of the surviving corporation. In reaching their decision the Boards of Directors of each corporation considered not only recent market prices of the securities of the two corporations, but also the preferred dividend to be paid to the TSC stockholders, the businesses and financial conditions of both corporations and various other factors.

At the request of TSC, the investment banking firm of Hornblower & Weeks-Hemphill, Noyes rendered a favorable opinion as to the fairness to the stockholders of TSC of the terms, set forth below, for the exchange of the shares of TSC for securities of National. The TSC Board considered this opinion in approving the sale. In such opinion, said firm considered, among other things, the current market prices of the securities of both corporations, the high redemption price of the National Series B Preferred Stock, the dividend and debt service requirements of both corporations, the substantial premium over current market values represented by the securities being offered to TSC stockholders, and the increased dividend income.

Hornblower & Weeks-Hemphill, Noyes did not receive a fee for its services. Mr. Blancke Noyes, a partner in said firm is, and has been since 1968, a Director of TSC. Mr. Noyes is the owner of 500 shares of TSC Series 1 Preferred Stock, 1,000 shares of TSC Common Stock and 100 shares of National Common Stock. Mr. Noyes' wife also beneficially owns 1,000 shares of TSC Common Stock. In March 1969, Hornblower & Weeks-Hemphill, Noyes acted as the principal underwriter in the public offering of 195,000 shares of TSC Common Stock.

National's Equity Interest in TSC

As noted above, National owns 519,733 shares (approximately 28%) of the presently outstanding shares of TSC Common Stock and 439,675 shares (approximately 46%) of the presently outstanding shares of TSC Series 1 Preferred Stock.

On February 7, 1969, National purchased from Mr. Charles E. Schmidt (then a director of TSC), his wife, his two sons, and a charitable foundation of which Mr. Schmidt was a trustee, 434,682 shares of Common Stock of TSC for cash and notes of National, totalling $13,040,460 ($30.00 per share) and 439,675 shares of TSC Series 1 Preferred Stock for cash and notes of National totalling $9,892,687.50 ($22.50 per share), the total of $22,933,147.50 being payable one-fourth in cash and three-fourths in 5% Notes of National payable in six annual installments. In addition, National transferred Warrants to said sellers granting them the right to purchase a total of 125,000 shares of Common Stock of National during the year commencing February 7, 1974 at $24 a share, subject to certain anti-dilution provisions.

Pursuant to an Agreement dated October 14, 1969, National purchased from Mr. Orville E. Peterson, a director of TSC and President of Big Bear, Inc., a subsidiary of TSC, his wife, brother and their immediate families 85,051 shares of Common Stock of TSC for cash and notes of National totalling $1,190,714 ($14.00 per share), being payable one-tenth in cash and the balance in 5% notes of National payable in six annual installments beginning on January 2, 1970.

National's Nominees on TSC's Board

At the request of National, Mr. Stanley R. Yarmuth, President and a Director of National, Mr. Charles F. Simonelli, Executive Vice President and a Director of National, Mr. Allan B. Solomon, Vice President of National, and Mr. Hyman Ullner, Cincinnati, Ohio, were elected Directors of TSC at the Annual Meeting of Stockholders of TSC held on March 31, 1969. At a subsequent Directors' Meeting, Mr. Jack Segell, President of G*E*S Stores, Incorporated, a subsidiary of National, was

elected a Director of TSC. The remaining directors of TSC, namely Mr. Blaneke Noyes, Mr. Orville E. Peterson, Mr. Richard H. Schaefer, President of TSC, Mr. Max J. DeForest, Vice President of TSC's Tractor Division, and Mr. Carl W. Sharfman, Vice President of TSC, are not affiliated with National.

Proposed Transaction

Under the applicable provisions of the Agreement, on the Closing Date (therein defined) TSC will sell to Transferee substantially all its assets, properties and business. In consideration therefor, Transferee will assume substantially all of the liabilities of TSC, and National will issue to TSC sufficient National securities so that each outstanding share of TSC Series 1 Preferred Stock will be exchanged upon liquidation of TSC for .6 share of National Series B Preferred Stock and one National Warrant, and each share of TSC Common Stock will be exchanged for .5 share of National Series B Preferred Stock and one and one-half National Warrants.

Each full share of National Series B Preferred Stock will be entitled to a cumulative quarterly dividend at the annual rate of $1.25 a share, accruing from the last dividend payment date, will be convertible, on and after the date of issuance, into .75 share of National Common Stock (subject to adjustment), will be entitled to one vote, may be redeemed by National at any time after the Closing Date at $26 per share, and will be entitled to a preference on liquidation of National.

Each National Warrant will entitle the holder to purchase one share of National Common Stock at a price of $21.40 per share (subject to adjustment) until October 31, 1978. For a further description of the terms and provisions of the National Capital Stock, the National Series B Preferred Stock and the National Warrant, see "Description of Capital Stock" and "Description of Warrants of National" herein and Appendices 1, 2 and 3 to the Agreement enclosed herewith as Exhibit B.

The National Series B Preferred Stock and National Warrants received by National as a stockholder of TSC will, when received by National in the liquidation and dissolution of TSC, be held in National's treasury until cancelled and retired or reissued.

The Agreement also provides, among other things, that:

(a) After the Closing TSC will, in accordance with the Plan of Complete Liquidation, promptly distribute to its stockholders in liquidation, the shares of National Series B Preferred Stock and National Warrants issued by National to TSC and will thereafter dissolve.

(b) TSC's name shall be changed to "TS Liquidating Company".

(c) National will assume the obligations of TSC under its employee stock options outstanding on the Closing Date. Each option to purchase shares of TSC will become options to purchase the maximum number of shares of Common Stock of National at the lowest price per share as is permitted by the Internal Revenue Code without such assumption being considered a modification thereunder.

(d) From the date of the Agreement to the Closing Date, TSC will not, without the prior written consent of National, declare or pay any dividend in excess of the regular quarterly dividend of $.175 per share on its Series 1 Preferred Stock or declare or pay any dividend on its common stock.

If approved at the shareholders' meetings, and unless abandoned or terminated as provided in the Agreement (see "Rights of Termination" below), the sale of assets will be consummated as soon as practicable after the shareholders' meetings.

Other Provisions of Acquisition Agreement

There is set forth below a summary of certain other provisions of the Agreement. The preceding discussion of the Agreement and the following summary does not purport to be complete, and are subject in all respects to the provisions of the Agreement, a copy of which is enclosed herewith as Exhibit B.

Fractional Interests. No fractional shares of National Series B Preferred Stock or fractional interests in National Warrants (and no scrip certificates for any of the foregoing) will be issued.

In lieu thereof, arrangements will be made whereby each person entitled to a fractional interest will be given an opportunity during the 60-day period following the Closing of the transaction to instruct an Exchange Agent, acting as agent for the holders of such fractional interests, either to purchase such fractional interest as is necessary to make up one whole share or one whole warrant or to sell any such fractional interest to which such holder is entitled.

If no request for the purchase or sale of fractional interests is received by the Exchange Agent simultaneously with the surrender of any certificates during such 60-day period, the Exchange Agent will sell any fractional interests relating thereto for the account of the holder thereof and will pay to such holder his pro rata portion of the proceeds of sales of such fractional interests, without interest. Purchase and sale orders for fractional interests will be effected at reasonable intervals on the basis of prevailing prices in the open market. Promptly after the aforesaid 60-day period the full shares and warrants representing all fractional interests with respect to which no instructions have been received will be sold. The proceeds thereof will be held by the Exchange Agent for the persons entitled thereto for six years from the Closing of the Agreement, after which, unless otherwise provided by law, unclaimed monies will be paid over to National. No service charges, brokerage commissions or transfer taxes will be payable by holders of fractional interests in connection with such purchases or sales, all of which will be paid by TSC.

Notification of Closing. If the necessary approvals of shareholders are obtained and the transactions hereinabove described are consummated, the Exchange Agent will forward to all TSC stockholders a letter of transmittal containing full instructions for the surrender of TSC stock certificates and for the purchase or sale of fractional interests in National Series B Preferred Stock or National Warrants. Accumulated dividends on National Series B Preferred Stock will be distributed to each TSC stockholder only upon exchange of his TSC stock for National securities.

Waivers and Amendments. The parties may waive in writing any of the conditions precedent to their respective obligations. In addition, the Agreement may be modified or amended by the Boards of Directors of the respective parties at any time before or after approval and adoption by the respective shareholders to further the purposes thereof, to clarify the intention of the parties, to add or modify or waive the covenants, terms or conditions thereof, to facilitate any opinion, or to effect or facilitate any governmental approval or acceptance of the acquisition contemplated thereby.

Rights of Termination. The Agreement may be terminated at any time either before or after the meetings of the shareholders of TSC and National, by agreement of the Board of Directors of TSC and National. The Agreement can also be terminated by either party in the event that the other party fails to perform any obligation or comply with any covenant or condition of the Agreement which must be performed or complied with by the Closing Date or has made any inaccurate representation or warranty in the Agreement, or in the event of a material adverse change to the other.

Consents of Certain Lenders. Under the terms of a Loan Agreement with The First National Bank of Chicago, TSC must obtain the consent of the Bank to a sale of substantially all of its assets to Transferee. The Bank has indicated that it will consent to the transactions provided that National agrees as follows:

(i) To maintain the business of TSC in a subsidiary of National;

(ii) National cannot withdraw any funds from Transferee by way of dividend, loan or otherwise during the period commencing January 1, 1970 and ending December 31, 1970, unless the net after tax earnings of TSC (and its successor, Transferee) are at least $2,000,000 for the fourteen month period ending December 31, 1969. If the minimum earnings figure is achieved, sums only in excess thereof can be withdrawn. A similar restriction applies for all subsequent years until the loan is paid in full, except that the minimum earnings must be achieved during the prior twelve month period ending on December 31.

(iii) National must guarantee the obligation of Transferee to the Bank.

National has agreed to the foregoing conditions.

Prior to the Closing, consents of various other lenders of National and TSC will have to be obtained unless such consents are waived or adequate provisions for the payment of the debts are made.

Accounting Treatment

The TSC acquisition will be accounted for as a purchase of TSC assets by National. Ernst & Ernst, independent accountants for National, have reviewed and approved this accounting treatment as being in accordance with generally accepted accounting principles.

Federal Tax Consequences

It is the opinion of counsel for TSC that based upon the Federal income tax laws in effect on the date of this Proxy Statement, (1) no Federal income taxes will be paid by TSC as a result of the sale of its assets to National; (2) the receipt of National securities by TSC stockholders in exchange for their TSC stock upon the liquidation of TSC will result in the recognition of gain or loss to TSC stockholders for Federal income tax purposes; the amount of such gain or loss will be the difference between the basis of a TSC stockholder's TSC shares and the aggregate fair market value on the date of distribution of the National securities and any other property received in exchange for such TSC shares upon liquidation of TSC; if the TSC Stock was held as a capital asset in the hands of the stockholder, the gain will constitute capital gain or loss, subject to the provisions and limitations of Subchapter P of Chapter 1 of the Internal Revenue Code of 1954, as amended (the "Code"); (3) the basis of the National securities (including fractional interests in such securities, received by stockholders of TSC in exchange for their TSC Stock will be the fair market value of the National securities on the date of distribution thereof; (4) the holding period of the National securities received by the holders of TSC Stock will begin on the day after the distribution by TSC of such securities; (5) the sale by the Exchange Agent of fractional interests in National securities will result in gain or loss to the TSC stockholder on whose behalf such fractional interests are sold, measured by the difference between the amount received and the basis of TSC Stock; if such fractional interests constitute a capital asset in the hands of the stockholder, the gain or loss will constitute capital gain or loss, subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code.

National has received an opinion of its counsel stating that National will recognize a capital loss, as a stockholder of TSC, on the exchange of the TSC securities owned by it for the National securities. The amount of this capital loss depends on the fair market value of the National securities on the date of distribution, but based on current fair market value such loss would be approximately $9,200,000.

Federal Trade Commission Report

National has filed a Special Report with the Federal Trade Commission pursuant to the Commission's merger and acquisition reporting requirements.

Stock Exchange Listings

All presently issued and outstanding shares of National Series B Preferred Stock and National Warrants are listed on the New York and American Stock Exchanges, respectively. Prior to the consummation of the Agreement, National will apply for the listing on the respective exchange of the National securities to be issued to TSC and the shares of Common Stock reserved for conversion or exercise of the rights under such securities. Approval of the listing of these securities, upon official notice of issuance, on the New York and American Stock Exchanges, as the case may be, is a condition precedent to the consummation of the Agreement.

RIGHTS OF DISSENTING STOCKHOLDERS

The shareholders of TSC and National will have no appraisal rights under the applicable laws of Delaware and Kentucky in connection with this transaction and the liquidation and dissolution of TSC.

MARKET PRICES OF SECURITIES

National's Common Stock and Series B Preferred Stock are listed on the New York Stock Exchange and National's Warrants are listed on the American Stock Exchange. TSC's Common Stock and Series 1 Preferred Stock are listed on the New York Stock Exchange. The high and low sales prices of such securities for the quarterly periods indicated were:

	NATIONAL						TSC(4)			
	Common Stock(1)		Series B Preferred Stock(2)		Warrants(3)		Common Stock		Series 1 Preferred Stock	
Period	High	Low	High	Low	High	Low	High	Low	High	Low
1967										
First Quarter	5⅛	3⅛	—	—	—	—	—	—	—	—
Second Quarter	5¼	4⅜	—	—	—	—	—	—	—	—
Third Quarter	14	4⅜	—	—	—	—	—	—	—	—
Fourth Quarter	24⅜	12	—	—	—	—	—	—	—	—
1968										
First Quarter	29⅞	16⅞	—	—	—	—	25⅞	20⅛	19½	15⅝
Second Quarter	26¼	18½	—	—	—	—	33⅝	22	24½	17
Third Quarter	28⅝	20½	23½	20½	—	—	30⅝	24⅝	22½	18⅞
Fourth Quarter	25	21⅝	25¼	21	16⅝	8⅝	34½	27	25⅞	20
1969										
First Quarter	24⅝	15⅞	23½	19⅛	15	9⅝	29⅝	20⅝	21⅞	15⅝
Second Quarter	17	11	20¼	16½	9⅞	5¼	22⅝	14½	17⅝	12⅛
Third Quarter	18⅛	9⅝	18	14⅝	7	4¼	16½	8½	14	9⅞
Fourth Quarter (to November 7)	11⅝	8⅞	17	15	6⅝	5	13⅜	10⅛	12⅝	9⅞

(1) The prices for 1967 of National Common Stock are bid prices in the over-the-counter market as reported by the National Quotation Bureau, Inc. Such quotations represent interdealer prices without adjustment for retail markup, markdown or commission. They do not represent actual transactions. On January 4, 1968, the National Common Stock was listed for trading on the American Stock Exchange. On July 2, 1968, the National Common Stock was listed for trading on the New York Stock Exchange. The prices during 1969 reflect the payment of a 2% stock dividend on February 10, 1969 to common shareholders of record on January 6, 1969.

(2) The National Series B Preferred Stock was initially issued on July 2, 1968, and such shares were immediately listed for trading on the New York Stock Exchange.

(3) The National Warrants were initially issued on November 1, 1968 and were listed for trading on the American Stock Exchange on November 27, 1968.

(4) TSC Common Stock and Series 1 Preferred Stock were initially issued on February 19, 1968, and were immediately listed for trading on the New York Stock Exchange.

On November 7, 1969, the closing prices of such shares were as follows:

National Series B Preferred Stock:—$16⅝

National Warrants:—$5¼

TSC Common Stock:—$13¼

TSC Series 1 Preferred Stock:—$12

DIVIDEND POLICY OF NATIONAL

National has never paid a cash dividend on its Common Stock. The dividend requirements of the National Series A and Series B Preferred Stock are set forth below under "Description of Capital Stock".

The Board of Directors has not adopted a formal policy concerning future dividends on Common Stock. Payment of dividends in the future is within the discretion of the Board of Directors and will depend, among other factors, upon future earnings, capital requirements and financial conditions. See "Description of Capital Stock" with respect to the restrictions on the payment of cash dividends.

In December 1966 and December 1967, National paid non-cash dividends to its Common shareholders at the rate of one share of Common Stock of Retail Centers of the Americas, Inc. for each one hundred shares of National Common Stock. On February 10, 1969, National paid a 2% stock dividend to its Common shareholders of record on January 6, 1969.

CAPITALIZATION

The following table sets forth the capitalization at August 31, 1969 of National Industries, Inc. and consolidated subsidiaries and TSC Industries, Inc. and consolidated subsidiaries and the pro forma combined capitalization of National and TSC to reflect National's acquisition of TSC which is described in this proxy statement.

	National Industries, Inc. and Consolidated Subsidiaries	TSC Industries, Inc. and Consolidated Subsidiaries	Adjustments (Dr.) Cr.	National TSC Pro Forma Combined
Short-term debt—notes payable—primarily to banks	$20,422,000	$ 7,451,000		$27,873,000
Long-term debt—including current maturities of $21,386,000 and $1,372,000:				
Secured:				
Bank notes—5½% minimum to ½% above prime rate (8½% at August 31, 1969)—$2,646,000 payable in the twelve-month period ending August 31, 1970; $1,652,000 by August 31, 1971; $655,000 by August 31, 1972; $623,000 by August 31, 1973—collateralized by common stock of a consolidated subsidiary, National's interest in gross income from oil and gas properties and other investments	$ 5,576,000			$ 5,576,000
Bank notes—½% above prime rate payable in seven annual installments; $750,000 on January 15, 1970, $2,000,000 annually for five years commencing January 5, 1971 and a final installment of $2,750,000 on January 5, 1976		$13,500,000		13,500,000
Mortgage notes—collateralized by real estate—5% to 8%—payable in varying installments	6,025,000	3,785,000		9,810,000
Installment equipment notes—5% to 7¾%—due in monthly installments of varying amounts	4,094,000			4,094,000
Unsecured:				
Notes to banks and others—principally at a rate of ½% above prime rate—including $13,774,000 payable in the twelve-month period ending August 31, 1970 and the remainder in various installments to 1979	14,258,000			14,258,000
Notes to insurance companies—5½% to 6½%—$762,000 payable in the twelve-month period ending August 31, 1970, $916,000 per year through 1974 (beginning August 31, 1971), and increasing amounts thereafter	12,750,000			12,750,000
6% senior notes maturing through 1977	1,200,000			1,200,000
5% subordinated debentures—due January 1, 1976	476,000			476,000
6½% note payable in equal installments in 1970 and 1971, and sundry debt		706,000		706,000
Other notes payable—5% to 6½%—$1,005,000 payable in the twelve-month period ending August 31, 1970; $751,000 by August 31, 1971; $670,000 by August 31, 1972; $535,000 by August 31, 1973; $533,000 by August 31, 1974; $22,000 by August 31, 1975, and the remainder in various installments	3,804,000			3,804,000
5% installment promissory notes—$2,293,000 payable in the twelve-month period ending August 31, 1970; $2,293,000 per year through 1974 beginning August 31, 1971 and $5,735,000 by August 31, 1975	17,200,000			17,200,000

	National Industries, Inc. and Consolidated Subsidiaries	TSC Industries, Inc. and Consolidated Subsidiaries	Adjustments (Dr.) Cr.	National TSC Pro Forma Combined
Convertible subordinated debentures and notes—unsecured:				
5¾%—due October 1, 1988—convertible into Common Stock of National at $23.53 a share ..	24,997,000			24,997,000
5½%—due January 1, 1980—convertible into Common Stock of National at $32.08½ a share	5,890,000			5,890,000
6%—due June 15, 1977—convertible into Common Stock of National at $26.47 a share until December 15, 1969 and $27.45 a share thereafter	400,000			400,000
	$96,670,000	$17,991,000		$114,661,000
Capital stock outstanding—less treasury stock:				
Preferred Stock, cumulative convertible, par value $1 a share:				
National:				
Authorized 5,000,000 shares:				
Series A, $ .60(1)	138,000 shs.			138,000 shs.(7)
Series B, $1.25(1)	182,000 shs.		975,000 shs.(6)	1,157,000 shs.(7)
TSC:				
Authorized 3,000,000 shares:				
Series 1, $.70(2)		912,000 shs.(4)	(912,000) shs.(6)	—
Common Stock, par value $1 a share:				
National (less 87,000 shares in treasury):				
Authorized 12,000,000 shares (20,000,000 pro forma combined)(3)	6,615,000 shs.			6,615,000 shs.
TSC:				
Authorized 5,000,000 shares		1,853,000 shs.(5)	(1,853,000) shs.(6)	—

NOTES:

(1) The $.60 Series A Cumulative Convertible Preferred Stock of National is convertible into 1.4 shares of Common Stock of National, is redeemable beginning in 1973 at $31.50 a share and descending by $.375 a share each year thereafter, until a price of $30.00 is reached, has a $20.00 involuntary liquidation value and is recorded on the books of National at $1.00 par value. The $1.25 Series B Cumulative Convertible Preferred Stock of National is convertible into 0.75 shares of Common Stock of National, is redeemable at any time at $26.00 per share, has a $26.00 involuntary liquidation value and is recorded on the books of National at $1.00 par value.

(2) The $.70 Series 1 Cumulative Convertible Preferred Stock of TSC is convertible into .75 shares of Common Stock of TSC, is redeemable at any time after July 1, 1973 at $17.00 per share and is recorded on the books of TSC at $1.00 par value. The holders of series 1 preferred stock are entitled to all arrearages in dividends thereon to the date of a liquidation payment and share ratably with holders of the common stock on the basis that the shares of series 1 preferred stock shall be deemed to be equal to the number of shares of common stock into which they are convertible at the date fixed for the liquidation payment.

(3) As of August 31, 1969 prior to National's acquisition of TSC, shares of National's Common Stock were reserved for issuance as follows:

Exercise of employee stock options	328,000 shares
Exercise of warrants	650,000 shares
Conversion of Preferred Stock	330,000 shares
Conversion of Debentures	1,262,000 shares
Issuance of contingent shares in pooling transactions	246,000 shares

Subsequent to National's acquisition of TSC, shares of National's Common Stock will be reserved for issuance as follows:

Exercise of employee stock options	450,000 shares
Exercise of warrants	3,164,000 shares
Conversion of Preferred Stock	1,061,000 shares
Conversion of Debentures	1,262,000 shares
Issuance of contingent shares in pooling transactions	246,000 shares

(4) Including 439,675 shares owned by National.

(5) Including 434,682 shares owned by National and 55,051 shares purchased by National in October, 1969 from individuals.

(6) To reflect National's issuance of 1,498,000 shares, less 523,000 shares received by National in liquidation of TSC (treated herein as returned to the status of unissued shares), of its $1.25 Series B Preferred Stock to TSC. Each outstanding share of TSC convertible preferred stock will be exchanged upon liquidation for 0.6 share of National $1.25 Series B Preferred Stock plus one National warrant and each share of TSC common stock will be exchanged upon liquidation for 0.5 share of National $1.25 Series B Preferred Stock plus one and one-half National warrants. Each National warrant will entitle the holder to purchase one share of National Common Stock at a price of $21.40 per share until October 31, 1978.

(7) The aggregate involuntary liquidation value of the Series A and B Preferred Stock is $32,842,000.

(8) See notes to consolidated financial statements of National and TSC for information concerning lease obligations.

NATIONAL INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES

STATEMENTS OF CONSOLIDATED INCOME

The following statements of consolidated income of National and its Consolidated Subsidiaries have been examined for the three years ended December 31, 1968 by Ernst & Ernst, independent accountants, whose opinion is based in part on the reports of other independent accountants. The reports of the independent accountants are included elsewhere herein. This statement should be read in conjunction with Notes (1) thru (8) following this statement, and other related financial statements and notes to consolidated financial statements of National included elsewhere herein. The statements for the year ended December 31, 1965 and six months ended June 30, 1968 and June 30, 1969 are unaudited; however, in the opinion of management all adjustments, consisting only of normal recurring accruals, necessary for a fair statement of the results of operations for these interim periods have been included. The statement for the six months ended June 30, 1969 is not necessarily indicative of the results of operations for the year.

	Year Ended December 31, (1)				Six Months Ended June 30, (1) (Unaudited)	
	1965 (Unaudited)	1966	1967	1968	1968	1969
Income						
Net sales and operating revenues	$221,820,000	$267,814,000	$289,894,000	$341,355,000	$159,231,000	$175,651,000
Concession, service, and other income	5,043,000	5,462,000	6,121,000	7,042,000	3,662,000	3,742,000
	226,863,000	273,276,000	296,015,000	348,397,000	162,893,000	179,393,000
Expenses and other deductions						
Cost of goods sold, excluding depreciation, depletion, and amortization shown below, and operating expenses	173,561,000	212,590,000	229,074,000	270,981,000	124,875,000	142,863,000
Selling, administrative, and general expenses	37,519,000	41,714,000	43,950,000	49,960,000	25,140,000	25,509,000
Depreciation, depletion, and amortization	4,328,000	6,384,000	7,449,000	8,357,000	3,884,000	4,278,000
Interest expense	2,292,000	3,182,000	3,645,000	5,239,000	2,225,000	3,592,000
Exploration and development expenses	—	543,000	294,000	103,000	69,000	44,000
	217,700,000	264,413,000	284,412,000	334,640,000	156,193,000	176,286,000
Income before income taxes and following items	9,163,000	8,863,000	11,603,000	13,757,000	6,700,000	3,107,000
Income taxes(2)	3,766,000	3,406,000	4,346,000	6,020,000	3,144,000	1,036,000
	5,397,000	5,457,000	7,257,000	7,737,000	3,556,000	2,071,000
Less portion of income from continuing operations of pooled companies applicable to common stock purchased(1)	2,193,000	1,637,000	1,582,000	479,000	478,000	—
Income from continuing operations	3,204,000	3,820,000	5,675,000	7,258,000	3,078,000	2,071,000
Income (loss) from discontinued operations, net of tax(3)	1,261,000	876,000	1,001,000	(89,000)	186,000	(690,000)
Less portion of income from discontinued operations of pooled companies applicable to common stock purchased(1)	423,000	243,000	215,000	—	—	—
	838,000	633,000	786,000	(89,000)	186,000	(690,000)
Income before extraordinary items	4,042,000	4,453,000	6,461,000	7,169,000	3,264,000	1,381,000
Extraordinary items, net of tax(3)	380,000	620,000	1,715,000	—	—	303,000
Less portion of extraordinary items of pooled companies applicable to common stock purchased(1)	47,000	319,000	636,000	—	—	—
	333,000	301,000	1,079,000	—	—	303,000
Net Income(6)	$ 4,375,000	$ 4,754,000	$ 7,540,000	$ 7,169,000	$ 3,264,000	$ 1,684,000

	Year Ended December 31,				Six Months Ended June 30, (Unaudited)	
	1965 (Unaudited)	1966	1967	1968	1968	1969
Income per share of Common Stock and Common Stock equivalents(4):						
Income from continuing operations	$ .54	$ .52	$ .77	$ .97	$ .41	$ .37
Income from discontinued operations, net of tax	.15	.09	.11	(.01)	.03	(.09)
Income before extraordinary items	.69	.61	.88	.96	.44	.18
Extraordinary items, net of tax	.06	.05	.15	—	—	.04
Net Income	$ .75	$ .66	$1.03	$ .96	$ .44	$ .22

Fully diluted per share data is not presented, since there is no significant dilution.

Dividends(5)

NOTES TO STATEMENTS OF CONSOLIDATED INCOME

(1) The above statements include the operations of Cott Corporation (purchased 55% of outstanding common stock in November, 1967) and Crescent Corporation (purchased 37% of outstanding common stock in March, 1968) which were merged into National effective July 1, 1968, and the operations of Hawthorn Mellody, Inc. (purchased 52% of outstanding common stock in July, 1968) and Royal School Laboratories, Inc. (acquired 59% of outstanding common stock in Crescent merger effective July 1, 1968) which were merged into National effective November 1, 1968. The initial purchases of stock and subsequent mergers were accounted for as part-purchases, part-poolings of interests. The entire operations of these four businesses have been included in the Statements of Consolidated Income and the portion of the income applicable to common stock purchased by National are deducted as indicated therein. Effective July 1, 1968 Retail Centers of the Americas, Inc. (approximately 66% (purchased) owned by National at January 1, 1965) was merged into National and accounted for as a part-purchase, part-pooling of interests. During the four years and six months ended June 30, 1969, National accounted for nine other businesses acquired as poolings of interests and sixteen other businesses acquired as purchases, (see Note A of Notes to Consolidated Financial Statements) four of which were purchased during 1968 and three of which were purchased during the six months ended June 30, 1969. The sales, net income, and income per share attributable to the seven businesses purchased in 1968 and six months ended June 30, 1969, are not significant.

The operations of Cott Corporation for the years ended April 30, 1966 and 1967 and December 31, 1967 and 1968, and Hawthorn Mellody, Inc. for the years ended March 31, 1966, 1967 and 1968 and December 31, 1968, have been consolidated with National's December 31, 1965, 1966, 1967, and 1968 statements of consolidated income respectively. The operations of two of the pooled companies whose fiscal years ended July 31, 1965 and the operations of one of the pooled companies whose fiscal year ended June 30, 1965 have been consolidated with National's December 31, 1965 statement of consolidated income. Appropriate adjustments have been made to retained earnings for the differences in fiscal years.

(2) Net income from subsidiaries domiciled in Puerto Rico is as follows: 1965—$590,000; 1966—$348,000; 1967—$580,000; 1968—$558,000, and six months ended June 30, 1969—$50,000. The undistributed earnings of these subsidiaries is approximately $3,035,000 and $3,085,000 at December 31, 1968 and June 30, 1969 respectively. Under Puerto Rico tax laws, National's Puerto Rico subsidiaries are subject to income tax at graduated rates up to 36.75%. Earnings of the Puerto Rico subsidiaries remitted to National in the form of dividends would generally be subject to combined income taxes at a higher effective rate than those on dividends received from its United States subsidiaries. The approximate amount of additional income tax liability in the event the undistributed earnings are repatriated would be approximately $1,200,000 at December 31, 1968 and June 30, 1969; however, National has no present intention of repatriating the undistributed earnings, as they are needed for present operations in Puerto Rico.

National and its subsidiaries follow the flow-through method of accounting for the investment credit. The effect on the provision for federal income taxes for the six months ended June 30, 1969 approximated $289,000; the effect on prior periods is not significant.

(3) Income (loss) from discontinued operations and extraordinary items consist of the following:

	Year Ended December 31,				Six Months Ended June 30, (Unaudited)	
	1965 (Unaudited)	1966	1967	1968	1968	1969
Income (loss) from discontinued operations, net of applicable tax:						
Nysco Laboratories, Inc. sold in 1966 by Cott Corporation	$ 121,000	$ 21,000	$ —	$ —	$ —	$ —
Crescent Corporation sold certain subsidiaries in 1967 and in 1968 divested the operations of certain companies acquired in 1965	984,000	638,000	592,000	—	—	—
International Life Insurance Company of the Americas sold in 1966 at book value	(110,000)	(70,000)	—	—	—	—
La Salle National Insurance Company sold in 1969	266,000	287,000	409,000	(89,000)	186,000	(690,000)
Total Income (Loss) from Discontinued Operations	$1,261,000	$ 876,000	$1,001,000	$ (89,000)	$ 186,300	$ (690,000)
Extraordinary items, net of applicable tax:						
Credit arising from adjustment in anticipation of settlement of pending tax matters relative to Crescent Corporation — no tax effect	$ 325,000	$ —	$ —			$ —
Termination of trade litigation, (federal income tax benefit 1965 —$120,000; 1966—$216,000)	(130,000)	(234,000)	—			—
Gain or (loss) on sale of subsidiaries, (federal income taxes 1966 — $265,000; 1967 — $1,096,000; 1969—$865,000)	—	796,000	1,566,000			303,000
Excess of amount received over carrying amount of condemned property—no tax effect	185,000	—	—			—
Expenses related to administrative proceedings, (federal income tax $154,000)	—	—	(166,000)			—
Retroactive adjustment for tax benefit from net operating loss carryforwards	—	103,000	315,000			—
Loss on disposition of idle facilities (federal income tax benefit of $40,000)	—	(45,000)	—			—
Total Extraordinary Items	$ 380,000	$ 620,000	$1,715,000			$ 303,000

In August, 1969, National entered into a contract for the sale of its investment in Southern Tank Lines Inc. and subsidiary, T. I. McCormack Trucking Co., Inc., for an aggregate sales price of $2,000,000 to be paid $200,000 in cash upon final approval of the transaction by the Interstate Commerce Commission, and $1,800,000 by a promissory note with interest at two percent below the prime rate. The gain, net of tax, will approximate $300,000. Further, the buyer is to assume certain indebtedness aggregating approximately $700,000 owed to National by the subsidiaries being sold, to be paid $200,000 in cash upon final approval by the Interstate Commerce Commission and $500,000 by a promissory note bearing interest at 6%. The two notes are due in twenty equal semi-annual installments beginning six months after final approval by the Interstate Commerce Commission. Temporary authority to operate the trucking companies was granted to the buyer on September 24, 1969 by the Interstate Commerce Commission pending consideration of the application for final approval of the sale.

The operating revenues and net income (loss) of Southern Tank and subsidiary and the increase or (decrease) in income from continuing operations per share, which would result if the net income (loss) of Southern Tank and subsid-

iary were classified as income (loss) from discontinued operations, for the three years and six months ended June 30, 1969, are as follows:

	Year Ended December 31,			Six Months Ended June 30, (Unaudited)	
	1966(a)	1967	1968(b)	1968	1969
Operating revenues	$1,027,000	$4,278,000	$6,062,000	$2,852,000	$3,969,000
Net income (loss)	(19,000)	116,000	(217,000)	(60,000)	(151,000)
Increase or (decrease) in income from continuing operations per share of National's Common Stock and Common Stock equivalents	—	(.02)	.03	.01	.02

(a) Includes results of operations of Southern Tank Lines Inc. from date of purchase, September, 1966.

(b) Includes results of operations of T. I. McCormack Trucking Co., Inc. from date of purchase, June, 1968.

(4) Income per share of Common Stock and Common Stock equivalents was computed by dividing net income available for Common Stock by the weighted average number of shares of Common Stock and Common Stock equivalents outstanding during the year, as follows:

	Year Ended December 31,				Six Months Ended June 30, (Unaudited)	
	1965 (Unaudited)	1966	1967	1968	1968	1969
Common Stock(c):						
Average Common Shares outstanding during the period(a)	4,913,000	6,321,000	6,301,000	6,566,000	6,288,000	6,645,000
Common Stock equivalents(c):						
Contingent shares issuable in connection with pooling transactions	246,000	246,000	246,000	246,000	246,000	246,000
Common shares issuable upon exercise of stock options(b)	—	—	196,000	166,000	180,000	110,000
Common shares issuable upon exercise of warrants(b)	—	—	—	48,000	40,000	28,000
Common shares issuable upon conversion of $.60 Series A Preferred Stock	336,000	336,000	336,000	224,000	336,000	194,000
Common shares issuable upon conversion of 5¾% convertible subordinated debentures (formerly Retail Centers)	—	—	40,000	—	133,000	—
Total Common Stock and Common Stock Equivalents	5,495,000	6,903,000	7,119,000	7,250,000	7,223,000	7,223,000
Net income	$4,375,000	$4,754,000	$7,540,000	$7,169,000	$3,264,000	$1,684,000
Less dividend requirements on $1.25 Series B Preferred Stock	(227,000)	(227,000)	(227,000)	(227,000)	(114,000)	(114,000)
Add interest adjustment on 5¾% debentures, net of tax effect	—	—	14,000	—	18,000	—
Net Income Available for Common Stock	$4,148,000	$4,527,000	$7,327,000	$6,942,000	$3,168,000	$1,570,000

(a) Shares shown are net of Treasury Shares; and include shares issued in subsequent periods in pooling of interest transactions.

(b) Represents total shares under option or subject to warrant at the end of each period (including shares not presently exercisable), reduced by the number of shares which may be repurchased with the aggregate proceeds from the exercise of the options or warrants. Such purchases are deemed to have been made at the average market price of the Common Stock during each period.

(c) Adjusted to give retroactive effect to the 3% Common Stock dividend declared by the Board of Directors in December, 1968.

Income per share as reported herein differs from comparable amounts presented in National's 1968 annual report as follows:

	Year Ended December 31,	
	1967	1968
Net income per share, per 1968 annual report	$1.09	$1.02
Effect of contingent shares issuable in pooling transactions—lower market value of National Common Stock at June 30, 1969, results in more contingent shares than at December 31, 1968	(.03)	(.03)
Effect of considering stock options and certain warrants as Common Stock equivalents under APB #15, which was issued May, 1969	(.03)	(.03)
Net income per share as reported herein	$1.03	$ .96

See Notes G and H of notes to consolidated financial statements of National for details of conversion rates, stock options and warrants.

The following shares of Common Stock were issued on conversion of Preferred Stock and debentures and on exercise of stock options and warrants as indicated:

	Year Ended December 31, 1968	Six Months Ended June 30, 1969 (Unaudited)
Conversion of $.60 Series A Preferred Stock	112,000	31,000
Conversion of 5¾% convertible subordinated debentures (formerly Retail Centers) (Called December 26, 1968)	152,000	—
Exercise of stock options	27,000	18,000
Exercise of warrants	13,000	—

No significant amounts of these securities were converted or exercised prior to 1968.

(5) In 1966 and 1967, National paid a dividend in Retail Centers stock at the rate of one share of Retail Centers common stock for each one hundred shares of National Common Stock held. Cash was paid in lieu of issuing fractional shares. Dividends were not paid prior to 1966.

In 1968, a 2% Common Stock dividend was declared, payable February, 1969. There are no dividends in arrears on the $.60 Series A or $1.25 Series B Preferred Stock.

(6) Reconciliation with amounts reported for net sales and operating revenues and net income for 1965 and 1966 in National's prospectus dated October 3, 1968 relative to the sale of the 5¾% Convertible Subordinated Debentures due 1988 is as follows:

	Year Ended December 31	
	1965 (Unaudited)	1966
Net sales and operating revenues as previously reported	$104,029,000	$132,498,000
Net sales of pooled businesses, prior to year of pooling	117,791,000	135,316,000
Net sales and operating revenues as above	$221,820,000	$267,814,000
Net income as previously reported	$ 2,787,000	$ 3,500,000
Net income of pooled businesses, prior to year of pooling	1,588,000	1,254,000
Net income as above	$ 4,375,000	$ 4,754,000

Amounts for 1967 and 1968 are the same as those reported in National's 1968 annual report.

(7) The first year interest requirement on the 5% installment promissory note (relative to purchase of common and preferred stock of TSC Industries, Inc.) is $860,000. In addition thereto, interest expense is increased by $320,000, which is the approximate amortization of the prepaid interest expense; see Note G of notes to consolidated financial statements.

The related interest expense included in the statement of consolidated income for the six months ending June 30, 1969 is $479,000.

(8) The income statement for 1964 is not being presented since financial data for certain companies acquired subsequent to 1964, which have been accounted for as poolings of interests, is not readily available. For 1964 the approximate net sales and operating revenues, cost of goods sold and operating expenses and net income were $184,441,000, $146,049,000, and $3,308,000, respectively.

Income from continuing operations for the six months ended June 30, 1969, compared with the same period in 1968 declined. This decline in income was primarily the result of reduction in the profit margins on sales of fluid milk in several major markets because of price competition; a slow down in shipments and orders of school and institutional laboratory furniture and equipment arising, in part, from industry strikes and other economic conditions; and increased interest costs resulting from increased acquisition borrowings and higher interest rates.

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENT OF INCOME

The following consolidated statement of income of TSC Industries, Inc. and its consolidated subsidiaries has been prepared to include for all periods, on the basis of pooling of interests, the operations of the predecessor Tractor Supply Co. and its subsidiaries, the predecessor Community Discount Centers, Inc. and its consolidated subsidiaries, Big Bear, Inc. and its subsidiaries and SAS, Inc. and its subsidiaries. (See Note 1 to TSC's financial statements.) With respect to Community, the amounts included for the years ended October 31, 1964, 1965 and 1966 are for Community's operations for the years ended the following January 31. The statement has been examined by Checkers, Simon & Rosner, independent certified public accountants, for the five years ended October 31, 1968. as set forth in their opinion appearing elsewhere herein. The consolidated statement of income for the periods of nine months ended July 31, 1968 and July 31, 1969, respectively, are unaudited; in the opinion of the Company, such statements include all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the consolidated results of operations for these periods. The results of operations for the period of nine months ended July 31, 1969 are not necessarily indicative of the entire year ending October 31, 1969. This statement should be read in conjunction with the financial statements and related notes appearing elsewhere herein.

	Year Ended October 31,					Nine Months Ended July 31, (Unaudited)	
	1964	1965	1966 (Note A)	1967 (Note A)	1968 (Note B)	1968	1969
Net sales	$65,361,552	$74,522,250	$86,659,458	$99,188,326	$165,240,832	$121,286,233	$135,965,341
Cost of sales (Note 3)	47,324,923	55,252,376	64,149,451	72,974,631	122,246,334	89,874,872	102,234,521
Gross Profit	18,036,629	19,269,874	22,510,007	26,213,695	42,994,498	31,411,361	33,730,820
Selling, administrative and general expenses	13,774,473	15,244,668	17,099,329	19,901,055	34,545,436	24,948,183	29,254,812
Income From Operations	4,262,156	4,025,206	5,410,678	6,312,640	8,449,062	6,643,178	4,476,008
Other income	149,648	176,647	186,322	246,026	548,260	447,800	421,876
	4,411,804	4,201,853	5,597,000	6,558,666	8,997,322	6,910,978	4,897,884
Other deductions:							
Parent company's share of loss of unconsolidated subsidiary (income*)	19,896	75,945	85,163	75,080	16,577	12,179	63,641*
Interest expense—net	605,208	591,901	614,777	712,197	1,287,756	994,350	1,264,122
Miscellaneous	81,267	53,574	83,316	53,239	291,897	2,537	147,937
Total Other Deductions	706,371	721,420	783,256	840,516	1,596,230	1,009,066	1,348,418
Income Before Provision For Federal Income Taxes and Extraordinary Items	3,705,433	3,480,433	4,813,744	5,718,150	7,401,092	5,901,912	3,549,466
Provision for federal income taxes applicable to above income	1,759,633	1,607,143	2,207,144	2,639,170	3,555,190	2,934,000	1,765,000
Income Before Extraordinary Items	1,945,800	1,873,290	2,606,600	3,078,980	3,845,902	2,967,912	1,784,466
Extraordinary items:							
Compensatory payment from lessee on commutation of lease—(net of applicable income tax of $60,000)	67,500	—	—	—	—	—	—
Federal income tax reduction from carry over of prior years' operating losses	220,000	312,000	646,000	866,000	118,000	118,000	—
Total Extraordinary Items	287,500	312,000	646,000	866,000	118,000	118,000	—
Net Income	2,233,300	2,185,290	3,252,600	3,944,980	3,963,902	3,085,912	1,784,466
Preferred dividend requirements	649,935	806,469	956,003	981,249	980,095	742,671	533,747
Net Income Applicable to Common Stock	$ 1,583,365	$ 1,378,821	$ 2,296,597	$ 2,963,731	$ 2,983,807	$ 2,343,241	$ 1,250,719

	Year Ended October 31,					Nine Months Ended July 31, (Unaudited)	
	1964	1965	1966 (Note A)	1967 (Note A)	1968 (Note B)	1968	1969
Per share earnings:							
Common and common equivalent share earnings (Note C):							
Before extraordinary items	$ .97	$ .80	$1.24	$1.57	$2.10	$1.65	$ .73
Extraordinary items	.22	.23	.49	.65	.09	.08	—
Net Income	$1.19	$1.03	$1.73	$2.22	$2.19	$1.73	$ .73
Fully diluted earnings: (Note D):							
Before extraordinary items	$ .96	$ .85	$1.11	$1.29	$1.59	$1.22	$ .71
Extraordinary items	.14	.14	.27	.36	.05	.04	—
Net Income	$1.10	$ .99	$1.38	$1.65	$1.64	$1.26	$ .71
Dividends paid per Common Share outstanding (Note E)	$ .90	$ .60	$ .50	$ .515	$ .56	$ .42	$ .45

Note A—The operating results of Community Discount Centers, Inc. for the three months ended January 31, 1967 have been included in both the years ended October 31, 1966 and 1967. This resulted in a duplication of net sales of $12,881,811, net income of $696,595, common and common equivalent earnings per share of $.52 and fully diluted earnings per share of $.29.

Note B—The consolidated statement of income for the year ended October 31, 1968, set forth above, includes the following operations of twenty department stores as described in note 2 to the financial statements of TSC and under the caption BUSINESS AND PROPERTIES OF TSC—Community Division—General, located elsewhere in this proxy statement (fourteen stores acquired on October 27, 1967 plus one store opened August 1, 1968 collectively referred to herein as "Shoppers World Stores"; five stores acquired on April 1, 1968 and reopened on May 9, 1968 collectively referred to herein as "Kansas City Stores"):

	Shoppers World Stores (Year Ended October 31, 1968)	Kansas City Stores (May 9—October 31, 1968)	Total
Net Sales	$46,736,778	$5,690,186	$52,426,964
Net Income (Loss)	$ 415,000	$ (332,000)	$ 83,000
Common and common equivalent share earnings (loss)	$.31	$(.25)	$.06

Other than direct store expenses which are accounted for accordingly, all other costs and expenses of the Community Division have been allocated on a basis (generally sales) believed to be reasonable by the Company. Total net income of $83,000 is after deducting pre-opening expenses incurred (net of related taxes) of approximately $192,000, equivalent to Common and common equivalent share earnings of $.14.

Note C—Common and common equivalent share earnings are based upon earnings applicable to the total of the average number of outstanding shares of Common Stock after giving retroactive effect to the shares issued in pooling of interests transactions (see Note 1 of the financial statements of TSC), and shares of Common Stock which would be issuable upon the exercise of outstanding dilutive options to acquire Common Stock.

Note D—Fully diluted share earnings give effect to the reduction in earnings per share which would result from the conversion of the Series 1 Preferred Stock and the issuance (and subsequent conversion) of the Series 1 Preferred Stock upon the exercise of outstanding dilutive options to acquire the Series 1 Preferred Stock. The additional 47,000 shares of Series 1 Preferred issued to the former shareholders of SAS Inc. as explained in Note 10(a) to the financial statements of TSC have been considered as outstanding for all periods presented.

Note E—Dividends were paid on the outstanding common shares of TSC Industries, Inc. and predecessor Tractor Supply Co. No dividends were paid during the period on shares of the predecessor Community Discount Centers, Inc. During the year ended October 31, 1964, a $.05 dividend was paid on Class B shares of predecessor Tractor Supply Co. The final 150,000 Class B shares were converted during the year ended October 31, 1964 on a share for share basis to Class A shares of predecessor Tractor Supply Co. Upon the conversion, the Class B issue was fully retired and canceled.

Note F—Net sales and net income as originally reported to the shareholders of Tractor Supply Co. for the four years ended October 31, 1967 and the amounts arising from the pooling of interests with Community Discount Centers, Inc., Big Bear, Inc. and SAS Inc. are as follows:

	1964	1965	1966	1967
Net sales:				
As originally reported	$25,613,934	$28,587,376	$33,655,044	$46,023,054
Arising from pooling of interests	39,747,618	45,934,874	53,004,414	53,165,272
Total	$65,361,552	$74,522,250	$86,659,458	$99,188,326
Net income:				
As originally reported	$ 1,487,393	$ 1,326,092	$ 1,688,818	$ 2,004,298
Arising from pooling of interests	745,907	859,198	1,563,782	1,940,682
Total	$ 2,233,300	$ 2,185,290	$ 3,252,600	$ 3,944,980

The decrease in net income of TSC for the nine months ended July 31, 1969, as compared with the like period in the prior fiscal year was attributable to the Community Discount Division. The most significant factors that contributed to Community's adverse earnings report are: (1) markdowns of inventory at July 31, 1969, to give recognition to overstocks and merchandise conditions; (2) the anticipated losses on disposition of certain fixed assets; and (3) the reflection of nine months of operations at a loss for the Kansas City Stores as compared with only three months of operations in the prior fiscal year.

PRO FORMA COMBINED INCOME SUMMARY—Unaudited

The following unaudited summary shows the pro forma income and per share data of National Industries, Inc. and Consolidated Subsidiaries for the year ended June 30, 1969, and TSC Industries, Inc. and Consolidated Subsidiaries for the year ended July 31, 1969. The summary shows the pro forma effect of the National—TSC proposed transaction which will be accounted for as a purchase, as further described in the notes to the pro forma combined balance sheet included elsewhere herein.

	(000 omitted)			
	National Industries, Inc. and Consolidated Subsidiaries	TSC Industries, Inc. and Consolidated Subsidiaries	Adjustments Dr. (Cr.)	National-TSC Pro Forma Combined (8)(9)
Income				
Net sales and operating revenues	$357,775	$179,920		$537,695
Concession, service and other income	7,122	549	$ 207 (1)	7,464
	364,897	180,469	207	545,159
Expenses and other deductions				
Cost of goods sold and operating expenses	289,049	134,530		423,579
Selling, administrative and general expenses	50,329	37,857		88,186
Depreciation, depletion and amortization	8,751	1,476		10,227
Interest expense	6,606	1,558	785 (2)	8,949
	354,735	175,421	785	530,941
Income before income taxes and following items	10,162	5,048	992	14,218
Income taxes	3,912	2,386	(16) (1) (414) (2) 185 (3)	6,053
Income from continuing operations	6,250	2,662	747	8,165
Income (loss) from discontinued operations, net of tax	(964)	—	—	(964)
Income before extraordinary items	5,286	2,662	747	7,201
Extraordinary items, net of tax	303	—	—	303
NET INCOME	5,589	2,662	747	7,504
Preferred Stock dividend requirements	227	774	(774) (7) 1,219 (6)	1,446
Net income available for Common Stock	$ 5,362	$ 1,888	$ 1,192	$ 6,058
Income per share of Common Stock and Common Stock equivalent (4)(5):				
Income from continuing operations	$ .83	$ 1.16		$ .95
Income (loss) from discontinued operations, net of tax	(.13)	—		(.13)
Income before extraordinary items	.70	1.16		.82
Extraordinary items, net of tax	.04	—		.04
NET INCOME	$ .74	$ 1.16		$ .86
Fully diluted income per share of Common Stock (5)		$ 1.08		

Fully diluted per share data is not presented for National or for National-TSC pro forma combined since there is no significant dilution.

NOTES TO PRO FORMA COMBINED INCOME SUMMARY

(1) To remove dividends received by National from TSC for the year ended June 30, 1969, less applicable federal income tax.

(2) To charge operations for 7% interest (5% stated rate plus 2% imputed interest—see Note G of Notes to consolidated financial statements of National) on $17,200,000 (purchase price $23,285,000 less $140,000 assigned to warrants and $212,000 finders fee paid and cash paid to sellers of $5,733,000) for the purchase of 439,675 shares of the TSC outstanding $.70 Cumulative Convertible Preferred Stock and 434,682 shares of the TSC outstanding common stock, and 8⅓% interest (5% stated rate plus 3⅓% imputed interest) on the purchase price ($1,191,000) of 85,051 shares of the TSC outstanding common stock, less an appropriate reduction in income taxes. (Interest of $479,000 on these transactions is already included in National's interest expense for the year ended June 30, 1969).

(3) To adjust the income tax provision of TSC so as to eliminate tax credits obtained by election of multiple surtax exemptions. This election will no longer be available to TSC if National continues to file consolidated federal income tax returns.

(4) The calculations of National and pro forma income per share of Common Stock are based on the average number of Common Shares, including common stock equivalents, outstanding during the year, after recognition of the dividend requirement on the $1.25 Series B Preferred Stock. In connection with National's purchase of TSC, 1,498,000 shares, less 523,000 shares received by National in liquidation of TSC (treated herein as returned to the status of unissued shares), of National $1.25 Series B Preferred and 2,511,000 warrants (3,733,000 total issued, less 1,219,000 received by National in liquidation of TSC) to purchase National Common Stock will be issued to TSC. The rate will be 0.6 of a share of National $1.25 Series B Preferred Stock plus one National warrant for each share of TSC $.70 Cumulative Convertible Preferred Stock outstanding, and 0.5 of a share of National $1.25 Series B Preferred Stock plus one and one-half National warrants for each share of TSC common stock outstanding. Each National warrant will entitle the holder to purchase National Common Stock at a price of $21.40 per share at any time prior to October 31, 1978.

(5) TSC Common and Common equivalent per share earnings are based upon earnings applicable to the total of the average number of outstanding shares of common stock and shares of common stock which would be issuable upon the exercise of outstanding dilutive options to acquire common stock. Earnings per common share— assuming full dilution gives effect to the reduction in earnings per share which would result from the conversion of the $.70 cumulative convertible stock and the issuance (and subsequent conversion) of the $.70 cumulative convertible stock upon the exercise of outstanding dilutive options to acquire the $.70 cumulative convertible stock.

(6) Dividend requirements on 975,000 shares of National's $1.25 Series B Preferred Stock.

(7) Remove dividends on TSC preferred shares.

(8) This statement is not necessarily indicative of the results of operations as they would have been had the proposed purchase transaction been consummated at the beginning of the periods shown above.

(9) Studies will be made to determine the extent to which the excess of cost of National's investment in TSC over TSC's underlying net assets should be applied to various TSC assets. (See pro forma combined balance sheet following.) In the opinion of National's management, no significant amounts will be allocated to depreciable or amortizable assets which would result in significant future charges to income. National has not previously amortized amounts assigned to the excess of cost of investments over underlying net assets of consolidated subsidiaries acquired.

COMPARATIVE PER SHARE DATA

	Per Present Share of		
		TSC(5)(7)	
	National Common	Common	Preferred
Income from continuing operations(1)(3):			
Per share of Common Stock and Common Stock equivalents(2):			
Before purchase(1)	$ .83	$ 1.16	$ —
Pro forma after purchase(1)	.95	.38	.43
Fully diluted income per share of Common Stock(2):			
Before purchase(1)	.81	1.08	.81
Pro forma after purchase(1)	.92	.35	.41
Dividends per share:			
Before purchase	2% stock	.56	.70
Pro forma after purchase	—	.63	.75
Book values—National as of June 30, 1969, TSC as of July 31, 1969:			
Assuming no conversion of convertible preferred shares or convertible subordinated debt, no exercise of warrants or stock options, and no issuance of contingent shares:			
Before purchase	9.11	9.93	7.45
Pro forma after purchase	8.98	13.00(4)	15.60(4)
Assuming exercise or conversion of those securities which have a dilutive effect on book value per share, and issuance of all contingent shares:			
Before purchase	9.09	9.79	7.34
Pro forma after purchase	11.46(6)	4.30(6)	5.16(6)

(1) Excluding income (loss) from discontinued operations and extraordinary items. For information regarding income (loss) from discontinued operations and extraordinary items and the income (loss) per share related thereto, see the National—TSC pro forma combined income summary included herein.

(2) As defined in Note (4) and Notes C and D of notes to consolidated income statements of National and TSC, respectively.

(3) Based on National's income for the year ended June 30, 1969, and TSC's for the year ended July 31, 1969.

(4) Based on the involuntary liquidation value ($26.00 a share) of the National $1.25 Series B Preferred Stock issued to TSC shareholders.

(5) Computations are based on the National shares to be issued in connection with the purchase transaction, as set forth in Note (4) of notes to pro forma combined income summary. The involuntary liquidation value ($26.00 a share for National $1.25 Series B Preferred Stock) is used in computing book value of Preferred Shares.

(6) Assuming conversion of all outstanding National $1.25 Series B Preferred Stock.

(7) This data does not include any value applicable to warrants to be issued to TSC shareholders. (See page 10 for market prices of securities.)

BUSINESS AND PROPERTIES OF NATIONAL

National, through subsidiary companies, is engaged in diverse businesses, including retailing, soft drinks, dairy products, laboratory furniture, energy products and steel service centers. Its executive staff is based in Louisville, Kentucky. Each operating company has its own separate management which reports to and consults with one or more members of National's executive staff. National's executive staff is responsible for overall financial planning, including capital procurement and budget development. The executive staff is also responsible for corporate acquisitions.

National was incorporated under the laws of the Commonwealth of Kentucky on August 24, 1956, as Kentucky Industries Trust Company, Inc. It changed its name to National Industries, Inc., in 1963, when present management became associated with National. Prior to 1963 National held as its principal asset shares of a life insurance company which have since been sold. Since that time National has expanded its operations through acquisitions and the development of acquired businesses.

In June 1964 National acquired the assets of G•E•S Stores, Incorporated ("G•E•S"), subject to its liabilities, in exchange for shares of National Common Stock. In October 1964 National acquired a 66⅔% stock interest in Retail Centers of the Americas, Inc. ("Retail Centers") and in 1965 and 1966 acquired additional shares of Retail Centers on the open market. In February 1965 Retail Centers purchased G•E•S from National for cash. In April 1965 National acquired all of the stock of Lano Corporation for cash. In December 1965 The Kingwood Corporation was merged into National, and as a result National now owns all of the outstanding stock of Kingwood Oil Company. In 1966 National acquired substantially all of the stock of Louisville Taxicab and Transfer Company, all of the assets of which have since been transferred to National, as a result of which National became the owner of all of the stock of Southern Tank Lines, Inc., Yellow Cab Co. of Louisville and Southern Cab Corporation.

In 1967 National and its subsidiaries acquired for cash all of the outstanding stock of The Columbus Stove Company, Anderson Refining Company, its subsidiaries and certain affiliates, a 49% stock interest in Computer Research, Inc. (now General Nursing Homes Corporation) and a 55% stock interest in Cott Corporation. In December 1967 National acquired all of the stock of The Merry Manufacturing Company in exchange for shares of National Common Stock.

In 1968 National acquired all of the stock of Vanguard Industries, Inc., and Reliance Steel Corporation in exchange for shares of National Common Stock. In March 1968 National acquired for cash a 37% common stock interest in Crescent Corporation. On July 1, 1968, Retail Centers, Cott Corporation and Crescent were merged into National. On July 5, 1968, National acquired a 52% stock interest in Hawthorn Mellody, Inc. for cash, and in November of 1968 Hawthorn and Royal School Laboratories, Inc., 59% of which was acquired by National in the merger with Crescent Corporation, was merged into National. In December, 1968 National acquired Nelson Sales Company and affiliated corporations for cash and shares of National Common Stock.

In February and October 1969 National acquired its stock interest in TSC Industries, Inc., for cash and notes. In March 1969 National expanded its steel service center operations by acquiring Steel Coils, Inc., Clearing Steel, Inc., Cox Metal Processing Co., and Mitchell Steel, Inc. in exchange for National's Common Stock. In June, 1969 National enlarged its sportswear group by acquiring Irving Raincoat Co., Inc., and affiliated corporations for cash and shares of National Common Stock.

On June 11, 1969, National sold all of its shares of LaSalle National Insurance Company for cash and notes. On August 19, 1969, National entered into an agreement to sell its shares of Southern Tank Lines, Inc. (including its subsidiary, T. I. McCormack Trucking Co., Inc.) to Matlack, Inc., a subsidiary of Rollins Leasing Corp., for cash and notes. The sale is subject to approval by the Interstate Commerce Commission. Temporary authority to operate the trucking companies was granted to Matlack on September 24, 1969 by the Interstate Commerce Commission pending consideration of the application for approval of the sale. The revenues and earnings of LaSalle and Southern Tank Lines combined were less than 10% of National's revenues and earnings. National intends from time to time to continue to sell other assets and investments and to apply the proceeds of any such sales toward the retirement of short term bank debt.

The operations and activities of National are in the fields of consumer products, industrial products, retailing, energy products and services. The following tables set forth the approximate breakdown among classes of products or services of the gross revenues of National for the years ended December 31, 1967 and 1968 and the approximate percentages of revenues and income contributed by National's major lines of business as restated for acquisitions of business accounted for as poolings of interests and transactions accounted for as part purchase and part poolings of interests:

Classes of Products and Services	Percentage of Total Revenues	
	Year Ended Dec. 31, 1967	Year Ended Dec. 31, 1968
Consumer Products	55.9%	57.6%
Industrial Products	18.6%	18.0%
Retailing	10.7%	10.1%
Energy Products	11.7%	10.8%
Services	3.1%	3.5%

Lines of Business	Percentage of Total Revenues		Percentage of Income Before Certain Items(*)	
	Year Ended Dec. 31, 1967	Year Ended Dec. 31, 1968	Year Ended Dec. 31, 1967	Year Ended Dec. 31, 1968
Dairy & Ice Cream Products	38.5%	36.2%	26.7%	19.8%
Soft Drink Products	11.5%	13.7%	16.2%	33.3%
Retailing	10.7%	10.1%	13.3%	14.1%
Distribution and Marketing of Petroleum Products	10.6%	9.9%	10.3%	13.2%
Steel Service Centers	7.6%	8.5%	6.7%	10.6%

* Income before allocation of parent company charges, income taxes, deductions for the portion of income from operations of pooled companies purchased, income or loss from discontinued operations and extraordinary items.

Consumer Products Group

(A) **Cott Corporation**

(B) **Hawthorn Mellody, Inc.**

(C) **The Columbus Stove Company**

(D) **The Merry Manufacturing Company**

(E) **Vanguard Industries, Inc.**

(A) **Cott Corporation.** Cott Corporation ("Cott"), a Delaware corporation, is engaged in the production and sale of carbonated beverages and in the manufacture and sale of flavor concentrates. Cott's products are sold under the trademarks "Cott," "Cliequot Club," "Mission," "American Dry," "Big Giant Cola," "Quiky," "LoCafeen," and others.

Concentrates, which are extracts and flavors used as a base for nonalcoholic beverages, are manufactured from formulas developed by Cott and sold to approximately 275 franchised bottlers in the United States and foreign countries who are licensed by Cott to produce and market carbonated beverages under its trademarks. Many of Cott's franchised bottlers produce carbonated beverages in addition to those sold under Cott's trademarks. Virtually all franchise agreements continue until cancelled by the bottler upon written notice, or by Cott for breach of the franchise agreement on the part of the bottler. In 1968 sales of concentrates to franchised bottlers and others accounted for approximately 4% of Cott's total sales. The profit margin on sales of concentrates is substantially greater than on sales of bottled and canned beverages.

Cott also has licensing agreements with companies in Canada, Mexico and Spain authorizing the use of Cott formulas in the manufacture of concentrates and the exclusive right to the use of the Cott trademarks on a royalty basis. Cott intends to license the manufacture of concentrates in other foreign countries where considered advantageous.

Cott manufactures and sells carbonated beverages throughout the New England states, New Jersey, metropolitan New York, Pittsburgh, Pennsylvania, and Miami, Florida areas. Beverages sold under its trademarks include popular flavors, mixers, and diet beverages. Cott also produces soft drinks for sale under private label brands. Such production accounts for approximately 20% of sales, with lower profit margins than on sales of beverages carrying its own trademarks.

Beverages sold by Cott are produced in its nine plants by a process which consists of mixing carbonated treated water with flavoring syrup. Beverages are sold in various size bottles, returnable and non-returnable, and in cans. The use of non-returnable bottles and cans has been increasing continuously. Beverage sales are seasonal in nature, with a higher volume of sales in the summer months of June, July and August and during the holiday season in December.

Cott's products are sold through its own sales force and through distributors who are authorized to distribute Cott products in particular territories. Sales, either by Cott or by its distributors, are made to various retail beverage outlets, including supermarkets, grocery and variety stores, drug stores, restaurants and package stores. Beverages are delivered in cases to distributors and retailers by Cott by its own or by leased trucks or by contract carrier. Many distributors pick up cases at the bottling plant in their own vehicles. Where deliveries are made by Cott, Cott relies primarily on leased vehicles or contract carriers.

Prime ingredients used in the manufacture of concentrates include natural citrus and fruit juices, the supply of which, though normally readily available, is dependent on weather and other conditions. Other important raw materials and supplies used by Cott include water, sugar, saccharin, carbonic gas, bottles, cans, crowns, cases, cartons, labels and foil. Most of these items are purchased from several sources. None of the materials used by Cott is in short supply.

Cott operates nine bottling plants, an extract plant, and warehouses at the following locations:

(1) Premises owned by Cott:

Location	Approx. Square Foot Floor Space	Daily Capacity (on basis of 10 oz. cases)
New Haven, Conn.	81,000	20,000 cases
Millis, Mass.	300,000	82,000 cases
Elizabeth, N. J.	155,000	56,000 cases
South Portland, Me.	72,000	6,000 cases
Pawtucket, R. I.	28,000	(warehouse)
Hamden, Conn.	26,000	(extract plant)
Worcester, Mass.	15,000	(warehouse)

(2) Premises leased by Cott (at an aggregate annual rental of approximately $300,000):

Location	Approx. Sq. Foot Floor Space	Expiration Date (and Renewal Options)	Daily Capacity (on basis of 10 oz. cases)
Manchester, N. H.	277,000	1982	28,000 cases
Somerville, Mass.	120,000	1982	22,000 cases
Braddock, Pa.	62,000	1978 (three 5-yr. terms)	18,000 cases
Bronx, New York	20,000	1978	5,000 cases
Miami, Florida	63,000	1973 (two 5-yr. terms)	6,000 cases
Brooklyn, N. Y.	14,000	1978	(warehouse)
Hartford, Conn.	18,000	1978 (one 5-yr. term)	(warehouse)
Baldwin, N. Y.	12,500	1970	(warehouse)

Cott believes that the plants are adequate for present business activities and for some future expansion. Machinery and equipment at the plants are of varying ages. Cott considers that its plants, machinery and equipment are maintained in good condition and are adequately insured.

Substantial advertising expenditures are made by Cott and its franchisees to promote the sale of all beverages sold under the various Cott trademarks. The trademark, "It's Cott To Be Good" is well known in the New England, New Jersey and New York areas. Mass commercial media are used,

including radio and newspapers, as well as extensive use of outdoor signs and "point of sale" material. For the twelve months ended December 31, 1968, expenditures for advertising and sales promotion aggregated $1,500,000, which included direct advertising by Cott and contributions toward the advertising expenses of its franchisees.

Cott employs approximately 1,000 persons. It has followed the policy of conforming its wages and other benefits to those in the area in which the operations are conducted. Cott considers its relations with employees to be satisfactory.

The soft drink business in which Cott is engaged is highly competitive and many of Cott's competitors have substantially greater financial resources available for marketing efforts than does Cott. Cott competes at the consumer level not only with nationally advertised brands but also with private label beverages and with many local and regional bottlers. Sales of concentrates are in competition with those of numerous other producers of this line of products, including producers of concentrates of nationally advertised brands.

On October 18, 1969, the Federal Food and Drug Administration ordered that the use of cyclamates be discontinued. Diet beverages containing cyclamates account for approximately 15% of Cott's sales. The profit margin on diet beverages is greater than the margin on non-diet beverages. Cott is now withdrawing existing cyclamate inventories from some of its retail customers and distributors under various terms and conditions.

Cott is exploring possible alternative plans for the disposition of this inventory and of its other inventories of cyclamate products. At the present time Cott is not in a position to estimate what income, if any, may be realized from these plans. The effect of this situation on Cott's 1969 income cannot presently be determined but management estimates that the loss and related costs and expenses could approximate $250,000.

Cott has developed a low calorie formula using a combination of sorbitol and saccharin sweeteners which cost more to produce than beverages with cyclamate. Cott believes that beverages produced by this formula will be comparable in taste to the cyclamate products and will contain 75-80% less calories than the sugar formulated soft drinks.

(B) **Hawthorn Mellody, Inc.** Hawthorn Mellody, Inc. ("Hawthorn") is engaged in the business of processing and distributing dairy products, ice cream, frozen baked goods and pickles. Its products are sold under various tradenames and trademarks including "Hawthorn Mellody", "Mellody Maid", "Town Square", "Rich's", "Alderney" and "Pickle O' Pete". Dairy and ice cream products are marketed in the states of Illinois, Wisconsin, Ohio, Missouri, Iowa, Indiana, Kansas, Michigan, New York, New Jersey, and Pennsylvania. Other products are distributed over the north-east quarter of the United States.

Hawthorn purchases raw milk and other dairy products, processes and packages dairy products in paper cartons, glass bottles and other containers, and sells and distributes such products directly and through distributors to grocery stores, restaurants, hotels, institutions and home delivery customers. Raw milk is purchased directly from farmers in Wisconsin, Illinois, Kansas, Ohio, Indiana, New York and New Jersey, and is also purchased through cooperative marketing associations. Substantially all sales of dairy and ice cream products are made under its brand name "Hawthorn Mellody". Hawthorn's sale of fluid milk and milk products constitute approximately 80% of its total sales.

The Chicago metropolitan area accounted for approximately 27% of Hawthorn's total sales during the six months ended June 30, 1969, the New Jersey area approximately 16%, and the Wisconsin area approximately 16%. About 80% of its sales are made directly by Hawthorn's sales force and deliveries are made by Hawthorn's vehicles. Over 40% of Hawthorn's sales are made to chain stores operated by national chains. The combined sales to National Tea Co. and Loblaw, Inc. represented approximately 27% of Hawthorn's total sales during fiscal 1968. The maintenance of this volume of sales to these customers is dependent on Hawthorn's ability to continue to provide them with satisfactory services and products at acceptable prices. Both companies have been substantial customers of Hawthorn for more than ten years and management has no reason to believe that it will be unable to retain this business.

Hawthorn operates plants at the following locations:

1. Premises owned by Hawthorn

Location	Approximate Sq. Ft. of Floor Space
Chicago, Illinois	114,000
Cleveland, Ohio	52,000
Whitewater, Wisconsin	67,000
Kansas City, Kansas	34,000
Sharon, Pennsylvania	71,000
Perth Amboy, New Jersey	33,000
South Bend, Indiana	44,000
Waukesha, Wisconsin	20,000
Bowling Green, Ohio	40,000
Buffalo, New York	90,000
Plymouth, Indiana	69,000
Lake City, Pennsylvania	74,000
Redgranite, Wisconsin	108,000
Ripon, Wisconsin	20,000

2. Premises leased by Hawthorn

Location	Approximate Sq. Ft. of Floor Space	Lease Expiration Date (and Renewal Options)
Dayton, Ohio	36,000	1975 (one 5 Yr. Term)
Milwaukee, Wis.	18,000	1970
Chicago, Ill.	79,000	2015
Englewood, N. J.	20,000	1977 (Six 5 Yr. Terms)
Columbia, Mo.	20,000	1974

In addition to the foregoing facilities, Hawthorn owns or leases properties at approximately 25 locations which are used for receiving or distribution purposes. Leases on such distribution facilities have remaining terms of from 1 to 18 years. Aggregate annual rental paid for all facilities leased by Hawthorn is $207,500. Management considers its equipment to be well maintained, and that its facilities are adequate and suitable for the current volume of business and for moderate increases in present production. Hawthorn's motor equipment includes approximately 950 tractor, trailer and truck units and approximately 60 automobiles, substantially all of which are owned by Hawthorn. Hawthorn has approximately 2,400 employees.

The dairy business is highly competitive, with a considerable number of other companies competing with Hawthorn for supplies of milk as well as for sales. Profit margins are narrow and earnings are dependent on the maintenance of relatively large sales volume and on efficiency of operation and distribution. The industry is subject to regulation by the United States Department of Agriculture with respect to minimum prices paid to milk producers, and to license requirements and other controls by federal, state and local health authorities and other regulatory agencies, all of which are subject to legislative or administrative change from time to time, with varying impacts on the industry.

(C) **The Columbus Stove Company.** Columbus is a manufacturer of domestic gas and electric ranges in the low and medium priced fields. Its product line includes slide-in, free standing, stack-on and double ovens. Ranges are sold nationwide under the tradename "Columbus". Sales are made through sales representatives to appliance distributors and to furniture, department and appliance stores. Ranges are also produced for sale to mobile home manufacturers. Sales aids furnished by Columbus to its dealers include catalogues, point of sale material and newspaper ad mats.

Columbus owns a manufacturing and warehouse facility, consisting of approximately 120,000 square feet, located in two adjacent buildings in Columbus, Ohio. It employs approximately 250 persons, and maintains its own engineering department. It also utilizes the services of industrial

designers. Manufacturing operations consist of stamping, finishing, including porcelain enameling, and assembling. Raw materials and specialty parts not fabricated by Columbus are purchased from numerous suppliers. Production is currently at the rate of approximately 85,000 units per year. The manufacturing facility is adequate and suitable for existing operations, and the productive capacity of the plant is approximately 100,000 units per year without additions to equipment. The electric and gas range manufacturing business is highly competitive.

(D) **The Merry Manufacturing Company.** Merry is engaged in the manufacture of low-priced toys designed for the impulse buyer. Its product lines are sold year round and include toy jewelry, play cosmetic and dresser sets and children's purses, which sell at retail in the 29¢ to $2.00 range. New products being introduced in the 1970 line include toy tea sets and a children's real teeter totter watch. Merry sells its products through manufacturers representatives to toy jobbers, chain stores, discount houses and department stores throughout the United States and Canada. Sales are also made to foreign countries through its export representative. Component parts and raw materials are purchased domestically and abroad from numerous sources. Many components are fabricated by Merry. Toy sets are assembled, packaged and shipped from its plant in Cincinnati, Ohio. Merry maintains an art staff and a product development department to create and design new items and lines. Low-priced items are produced in large volume by coordinated, high-speed, mass assembly type operations, involving simple hand assembly as well as automated equipment.

Merry's plant consists of a modern building which contains office, production and warehouse facilities totaling approximately 90,000 square feet. The plant is leased at an annual rental of approximately $79,000. Merry's plant is a general purpose building, and its equipment is adaptable to various assembly operations suitable for types of products produced by Merry. Merry employs about 225 persons. The business of producing low-priced toys is highly competitive. Although Merry's products are widely distributed, it is a small factor in the total toy market.

(E) **Vanguard Industries, Inc.** Vanguard and subsidiary companies are engaged in the manufacture and distribution of specialty headwear for men, women and children, and in the importing and sale of sporting goods, rainwear, rubber footwear, camping and fishing equipment, inflatables, jackets and parkas. Vanguard maintains sales offices in New York City, Kansas City, Missouri, Los Angeles, California, Worcester, Massachusetts and Cleveland, Ohio. Sales are made through the company's sales force and through independent sales representatives. Customers include major chain stores, jobbers, distributors, department stores and outlets in the mass merchandising field. No one customer accounted for more than 5% of its total sales during 1968.

Sports headwear is manufactured at five company plants in Missouri and Iowa having an aggregate of 155,000 square feet of manufacturing space. Headwear is also purchased from other manufacturers by contract. Sporting goods and rainwear are manufactured in foreign countries in compliance with the design and specification requirements of Vanguard and are imported for distribution in the United States.

In addition to using public warehouses, warehouses for storage and shipment of goods are maintained as follows:

Location	Approximate Sq. Ft. of Floor Space	Lease Expiration Date (and Renewal Options)
Canoga Park, Calif.	28,000	1972 (one 3 yr. term)
Edison, New Jersey	24,000	1988 (one 3 yr. term)
Edison, New Jersey	47,000	1985
Worcester, Mass.	70,000	1971
Kansas City, Mo.	78,000	1973
Brooklyn, New York	78,000	1972

Manufacturing facilities are as follows:

Location	Approximate Sq. Ft. of Floor Space	Lease Expiration Date (and Renewal Options)
Pattonsburg, Mo.	40,000	1971
Grant City, Mo.	25,000	1990
Stanberry, Mo.	55,000	1971
Mount Ayr, Iowa	20,000	1992 (five 5 yr. terms)
Kansas City, Mo.	15,000	1983

Annual rentals for all warehouse and manufacturing facilities as a group are approximately $246,000.

Raw materials used in manufacturing operations consist of cotton goods, woolens and blended and synthetic fabrics and are purchased from numerous mills. Imported goods are secured from numerous suppliers. Vanguard and subsidiaries employ approximately 500 persons and management considers its relations with employees to be satisfactory. Vanguard's business is highly competitive and subject to changes in consumer preferences, material and production costs, tariffs and availability of goods.

Industrial Products Group

(A) **NII Laboratory Furniture, Inc.**

(B) **NII Steel Services Companies**

(C) **The Shultz Company**

(A) **NII Laboratory Furniture, Inc.** NII Laboratory Furniture, Inc. ("NIILF") a Delaware Corporation, is engaged in the design, engineering, manufacture and installation of laboratory furniture and equipment in educational, industrial and medical care facilities. The company manufactures a complete line, including steel and wood cabinets, tables, benches, storage cases and wall assemblies, acid-resistant table tops, fume hoods, and specialized processing equipment. NIILF also offers engineering services in laboratory design and layout and in the containment of gases and explosive atmospheres.

Sales are made primarily through competitive bidding. Bids generally are submitted for the installation of a laboratory in a new or renovated building in accordance with the architect's or customer's specifications. Sales are effected through company salesmen and through independent sales representatives who solicit orders throughout the United States. Bids are prepared by the company's estimating staff.

The company publishes illustrated catalogs of its major production lines, which are furnished to builders, architects and other persons engaged in the preparation of laboratory specifications. Inventories of component parts are maintained, but the company does not maintain a stock of finished products, since each installation is produced on a job order basis.

NIILF also designs and manufactures a complete line of library furniture, including shelves, tables, charging desks, carrels and card catalogue files. Sales are made to educational, industrial and public libraries throughout the United States. The products of this division are standardized and catalogued, but modifications are made to meet customers' specifications. As part of complete library installations, the company also supplies chairs and tables which are produced by other manufacturers. Sales are made through sales representatives and library furniture dealers who sell primarily on the basis of competitive bidding. Metalab, Royal School, Permalab, Labco, Laberaft, Eastone, Taylor Stone and Standard Wood Products are the principal divisions of NIILF.

Raw materials used in operations include steel sheets, shapes and plates, lumber, plywood, hardware, paint and glass. Plumbing and electrical parts and components, and various types of laboratory equipment are also purchased and are built in or installed in conjunction with its line. Raw materials and components are purchased from several sources and the company is not dependent upon any particular source of supply. NIILF is one of two producers of an impregnated sandstone table top, which is fabricated from natural stone quarried on property owned by the company. These tops are used by the company and are also sold to other laboratory equipment manufacturers. NIILF also fabricates for its own use and, to a smaller extent, for sale to others, composition stone laboratory table tops.

Installation of each laboratory, including connection of mechanical services, is performed by local construction tradesmen or local independent contractors under the supervision of NIILF personnel. Under its contracts NIILF is generally responsible for job installation.

The real properties of NIILF are as follows:

(1) Premises owned by NIILF:

Location	Approx. Sq. Ft. Floor Space
Ashland, Virginia	150,000
Los Angeles, California	53,000
Beverly, West Virginia	100,000
Nashua, New Hampshire	42,000
McDermott, Ohio	39,000
McDermott, Ohio	503 Acres (Quarry)

(2) Premises leased by NIILF:

Location	Approx. Sq. Ft. Floor Space	Expiration Dates (and renewal options)
Hicksville, New York	133,000	1975 (four 5-yr. terms)
Los Angeles, California	15,000	1970
Mineola, New York	109,500	1974

Annual rentals for all leased premises total $182,000.

NIILF considers its plants, machinery and facilities to be well maintained, in good operating condition and adequate for the purposes for which they are used. NIILF employs approximately 1,200 persons.

NIILF is one of many firms manufacturing wood and steel laboratory furniture and library furniture. Several of these firms are larger than NIILF and have greater resources. Sales are made primarily on the basis of competitive bidding in a highly competitive market.

(B) **NII Steel Services Companies.** Clearing Steel, Inc., Steel Coils, Inc., Cox Metal Processing Co., Reliance Steel Corporation and Mitchell Steel, Inc., operate steel service centers in Chicago, Illinois, Detroit, Michigan, and Nashville, Tennessee, and service customers in the midwest and southern states. Raw material is purchased from basic steel producers in mill form and is processed and delivered to customers in accordance with their specifications and requirements. Products handled by the service companies include coils, sheets, bars and plates. Processing capabilities include

cutting, shearing, slitting and edging. Processing and warehouse facilities are located in Chicago, Detroit and Nashville. The companies occupy a total of 247,000 sq. ft. of building space, 217,000 of which is owned and 30,000 sq. ft. is under a lease expiring in 1973. The companies also lease space in private and public warehouses from time to time.

The NII steel service companies service all types of users of steel including automotive, farm machinery, appliance and equipment manufacturers. The business is highly competitive and subject to fluctuation in the requirements of its customers. The NII companies are a small factor in their industry. The success of the NII companies' business is dependent upon high volume as the companies operate at close profit margins. No single customer accounts for more than 10% of the companies' sales. Although the service centers have followed the policy of purchasing raw materials from one principal supplier, raw materials are also available from other domestic and foreign sources of supply.

The steel service companies employ approximately 225 persons. Management considers relations with its employees to have been generally satisfactory, although its Detroit plant experienced a seven week strike in August and September of 1969.

(C) **The Shultz Company.** Shultz is a manufacturer of equipment specially designed for the supermarket industry, including wood and metal display fixtures, commercial walk-in refrigerators, steel display shelving, mechanically operated checkout stands, meat workroom equipment, plastic and aluminum doors and other specialty items. Shultz also performs contract carpentry work in conjunction with supermarket installations and remodeling. The area serviced by Shultz is primarily the Eastern Seaboard region. Its principal customers are The Great Atlantic & Pacific Tea Company, Grand Union and Safeway Stores. Substantially all sales are generated from repeat business of existing customers.

Shultz's products are manufactured at a plant containing approximately 120,000 square feet of factory and office space in two buildings in New York City occupied under a net lease expiring on December 31, 1975 which can be renewed for ten years. Raw materials, components and supplies purchased by Shultz include steel, aluminum and plastic sheets, shapes and extrusions, lumber, plywood, hardware, electrical parts and supplies, paint and adhesives, all of which are purchased from several suppliers. Shultz employs approximately 140 people, and relations with its employees are considered satisfactory.

Sales are made on the basis of competitive bidding or through established company prices which are reviewed annually or semi-annually with customers. Shultz competes with numerous manufacturers of supermarket furniture, some of whom operate in local areas and several of whom operate nationally and are larger and have greater resources than Shultz.

Retail Group

Retail Centers of the Americas, Inc. ("Retail Centers"), a Delaware corporation, operates twelve department stores known as the Bargain Town Stores, the Winston Store, the G•E•S Stores and the GOVCO Stores. The location and the date each store was opened is as follows:

Name	Location	Date Opened
Winston's	Hempstead, New York	June 1969
Bargain Town	Lawrence, New York	1961
Bargain Town	Ponce, Puerto Rico	1962
Bargain Town	Bayamon, Puerto Rico	1963
Bargain Town	Carolina, Puerto Rico	1965
G•E•S	Louisville, Kentucky	1960
G•E•S	Louisville, Kentucky	1967

Name	Location	Date Opened
G•E•S	Cincinnati, Ohio	1961
G•E•S	Birmingham, Alabama	1962
G•E•S	Birmingham, Alabama	1967
GOVCO	Indianapolis, Indiana	1965
GOVCO	Indianapolis, Indiana	1968

BARGAIN TOWN & WINSTON STORES:

These stores emphasize self-service and cash sales (although credit is available through independent finance companies without recourse to Retail Centers) and sell a broad variety of merchandise. A substantial portion of the merchandise is sold at discount prices. Departments include supermarket, automotive, toys, appliances, hardware, paints, linens, clothing, shoes, juvenile furniture, drugs and cosmetics, cameras, records, luggage, wheel goods and outdoor furniture.

Most of the departments in the Bargain Town and Winston Stores are operated by Retail Centers. However, in each store a number of departments are operated by licensees including supermarket, cameras and records, jewelry, shoes, ladies' wear, and appliances. The provisions of these licenses vary, but most provide for payment to Retail Centers of a percentage of the licensee's gross sales. The licenses are for varying terms, but most of them provide for a termination by either party upon 30 days' notice.

Bargain Town employs both newspaper and direct mail advertising. Advertising expenses have never exceeded 2.5% of annual gross sales. Purchases for the Bargain Town and Winston Stores are generally made by the company's buyers. During the fiscal year ended December 31, 1968, no one manufacturer accounted for as much as 10% of total purchases.

The Winston Store which opened in June 1969 has to date operated at a substantial loss. In the past five years two of the Bargain Town Stores in Puerto Rico have been damaged by fire which Retail Centers believes to have resulted from the work of arsonists. Such fires have had no adverse effect on the financial condition of Retail Centers since the resulting property and operating losses were adequately insured; nor have the operations of the Puerto Rican stores been affected adversely by the continuing possibility of arsonists' activity.

G•E•S AND GOVCO STORES:

The G•E•S and GOVCO Stores are the type of store generally classified in the retail industry as "closed-door membership department stores" by which the right to shop is limited to members and their families. Members pay a fee of $2.00 to $3.00 for a lifetime membership, which is non-assessable and free of renewal charges. The G•E•S concept of merchandising embodies low markup and overhead, high volume and concentration in predetermined markets.

Each G•E•S and GOVCO Store sells a broad variety of merchandise including furniture, appliances, housewares, hardware, jewelry, sporting goods, lawn and garden supplies, toys, men's, women's and children's clothing, shoes, cameras, luggage, auto accessories, tires, linens, records, drug and optical goods. Each store also has a supermarket, gasoline station and automotive service facility.

Most of the merchandise offered for sale in the G•E•S and GOVCO Stores is sold by licensees. However, the gasoline service stations, the liquor department in the Louisville stores, and the automotive supplies and service centers are operated by Retail Centers. The principal income of the G•E•S and GOVCO Stores is derived from payments received from licensees, and are based primarily on a percentage of total sales, although some additional service fees and minimum payments are involved in selected instances. The G•E•S and GOVCO Stores endeavor to maintain low advertising costs, and furnish the bulk of all advertising to their licensees as one of the services which is rendered in consideration for the payments received. Advertising is customarily provided through the

medium of direct mail. Licensees are responsible for their own employees, merchandise, fixtures, cashiering and other selling functions, including service. Retail Centers is responsible for providing space, utilities, maintenance, advertising, promotion, general store supervision and assistance in merchandising. Credit sales are available at all G•E•S and GOVCO Stores through various optional revolving credit plans for all types of merchandise except groceries and liquor. Credit plans are maintained by independent finance companies without recourse to Retail Centers.

With the exception of the licenses for the supermarkets in several of the stores, which are long term licenses with options to renew, all of the licenses are on a year-to-year basis, and in most instances may be terminated by either Retail Centers or the licensee on short notice. During 1968, only drugs and supermarkets accounted for more than 10% of the aggregate sales of G•E•S and GOVCO licensees.

All of the stores operated by Retail Centers are located on or near major highways. Real properties of the Division are as follows:

(1) Premises owned by Retail Centers:

Location	Mortgage Balance	Approx. Sq. Ft. of Floor Space	Parking Facilities
Lawrence, N. Y.	$1,821,000	193,000	800 Cars
Carolina, Puerto Rico	$1,711,663	130,000	650 Cars

(2) Premises leased by Retail Centers:

Location	Approx. Sq. Ft. of Floor Space	Parking Facilities	Expiration Date (Renewal Options)
Ponce, Puerto Rico	50,000	150 Cars	1977 (One 5 Yr. Term)
Bayamon, Puerto Rico	130,000	450 Cars	1993 (Five 5 Yr. Terms)
Louisville, Ky.			
Crittenden Dr.	102,000	1,040 Cars	1976 (One 10 Yr. Term)
Breckinridge Ln.	130,000	700 Cars	1992 (Five 5 Yr. Terms)
Birmingham, Ala.			
West Store	112,000	1,000 Cars	1982
Roebuck Store	130,000	1,000 Cars	1992 (Five 5 Yr. Terms)
Cincinnati	102,000	850 Cars	1986 (Four 5 Yr. Terms)
Indianapolis			
GOVCO—East	111,000	600 Cars	1993 (Four 5 Yr. Terms)
GOVCO—West	130,000	1,200 Cars	1993 (Five 5 Yr. Terms)
Hempstead, N. Y.	246,000	800 Cars	1999 (Five 5 Yr. Terms)

Annual rentals for all premises leased by Retail Centers total $1,701,000. In addition to fixed rentals, Retail Centers pays all taxes, utilities and other expenses on all of its leased stores. All physical properties are in good repair, are adequatedy insured (including business interruption insurance) and are suitable for the business conducted therein. However, insurance covering the Bargain-town and Winston stores contain provisions which require Retail Centers to bear the first $100,000 of any claimed loss at each store.

Retail Centers employs approximately 1,000 full-time employees and 350 part-time employees. Retail Centers believes that its relations with its employees are satisfactory.

The business of the Retail Division is seasonal, the largest sales volume occurring in the fourth quarter. Retail Centers is engaged in a highly competitive business, competing directly with many types of retail establishments, department stores, mail order houses, discount stores, supermarkets and gasoline service stations, a number of which operate in the market areas where its stores are located. The financial resources of many of the competitors of Retail Centers are greater than those of Retail Centers.

Energy Products Group

(A) **Kingwood Oil Company.**

(B) **Lano Corporation**

(A) **Kingwood Oil Company.** Kingwood maintains its principal office in Oklahoma City, Oklahoma. It is an independent operating oil company engaged principally in the production of crude oil and natural gas and the sale of such products directly to purchasers in the field. It is not engaged in the retail marketing of hydrocarbons.

For the past five years, Kingwood has been active in secondary recovery operations, but has not engaged actively in exploratory operations. Recently, a possibly significant gas discovery was made upon acreage adjoining oil and gas leases owned by Kingwood and third parties in the State of Ohio. The presence of a gas reservoir underlying the Kingwood acreage is conjectural and can only be established by actual drilling. Kingwood is now conducting preliminary studies preparatory to drilling a test well upon its acreage.

Kingwood's properties consist essentially of oil and gas leasehold estates and oil and gas reserves thereunder. It also owns pumping equipment, oil storage tanks, separators, compressors and other oil field properties and fixtures. The following tabulation shows, as of June 30, 1969, the approximate amount of Kingwood's producing oil and gas properties and the locations thereof. Net acreage there shown is Kingwood's interest in properties after deducting the fractional interests of others, except royalty and overriding interests.

	Gross Acreage	Net Acreage
Arkansas	233.00	216.00
Colorado	3,440.00	2,930.00
Illinois	6,338.41	4,714.54
Indiana	245.39	245.39
Kentucky	1,986.25	1,553.92
Louisiana	863.48	353.45
Mississippi	1,549.00	1,486.63
Nebraska	240.00	120.00
New Mexico	1,290.73	561.94
Oklahoma	20,348.87	15,275.70
Texas	3,539.32	2,378.43
Totals	40,074.45	29,836.00

As of June 30, 1969, Kingwood's non-developed oil and gas properties totalled approximately 30,315 net acres.

Kingwood owns an interest in approximately 3,123 oil wells and 70 gas wells which is equivalent to 269 net oil wells and 22 net gas wells. Kingwood also owns overriding royalties and royalty interests in varying amounts underlying approximately 24,867 acres located principally in Oklahoma, Texas, Illinois and Kentucky. Kingwood's net production of crude oil and natural gas liquids is approximately 2,663 barrels per day while its net daily natural gas production is approximately 8,933,000 cubic feet. During the first six months of 1969, Kingwood's net oil production amounted to 467,167 barrels, and its net gas production amounted to 1,659,668 M.C.F. Kingwood's petroleum engineers estimate proven and developed reserves at June 30, 1969, to be as follows:

Crude Oil and Condensate	5,984,095 Barrels
Natural Gas	38,033,725 M.C.F.

A substantial number of Kingwood's producing oil and gas leases are subject to a mortgage dated March 29, 1966, in the original principal sum of $4,000,000 with interest at 5¾% per annum payable in five annual installments, the first two installments in the amount of $500,000 each and the last

three installments in the amount of $1,000,000, commencing April 15, 1967, to and including April 15, 1971. As of June 30, 1969, $2,000,000 remained to be paid on this mortgage.

The percentages of sales accounted for by Kingwood's chief customers during the year ended December 31, 1968, were as follows:

Crude Oil	Natural Gas	Crude Oil and Natural Gas Combined
Ashland Oil & Refining Company—36.3%	Phillips Petroleum Company—23.2%	Ashland Oil & Refining Company—22.9%
Sohio Petroleum Company—26.5%	Oklahoma Natural Gas Company—12.4%	Sohio Petroleum Company—16.7%
Phillips Petroleum Company—7.5%	Southern Union Gas Company—8.8%	Phillips Petroleum Company—6.1%

Kingwood's natural gas sales, being approximately 17% of total sales, are made pursuant to long term contracts.

Kingwood has forty-two employees. The oil and gas industry is highly competitive and Kingwood, a minor factor in the industry, competes with many other companies having greater financial and other resources. Approximately 45% of Kingwood's total natural gas sales are subject to Federal Power Commission regulations and thus must meet rate schedules and certificate requirements applicable to such sales.

Approximately 50% of Kingwood's total oil and gas production is obtained in states which have enacted proration laws, but 85% of its total oil and gas production is not affected or limited by such laws.

(B) **Lano Corporation.** Lano sells, markets, transports and refines through subsidiaries a variety of gasolines, fuel oils, lubricating oils and other petroleum products. Lano markets, principally in Texas and Louisiana, petroleum products which are purchased principally from other refineries. These products, primarily gasoline and oil, are sold by Lano at retail and wholesale to various commercial and consumer accounts, including trucking companies, chemical plants, agricultural accounts, petroleum distributors, and several hundred service stations. Approximately 25% of the service stations supplied by Lano are operated by Lano and approximately 30% of such stations are subleased by Lano to independent operators. Approximately 50 of these stations are operated on a self-service basis. Lano has facilities available for the storage of these products. Distribution of these products is made by a variety of shippers, including a fleet of 35 motor vehicles licensed in Texas.

Lano also has a refinery located in Tucker, Texas, which has a capacity of 3,000 barrels per day. Its products include motor fuels, butane, stoddard solvents and jet fuel. Gasoline motor fuels account for approximately 60% of its production. Approximately 65% of the production of the refinery is distributed to its own gasoline service stations. The remaining 35% is sold to sundry buyers. The jet fuel produced is sold to the United States Government.

Lano's sales are made in volume quantities at a small unit markup. This business is highly competitive and by reason of the small unit markup and marketing conditions its profits may be subject to wide fluctuations. Lano's 1968 gross revenues of approximately $34,500,000 accounted for about 90% of the energy product division sales in 1968. Lano and its subsidiaries have approximately 250 employees. Lano considers that its relations with employees are satisfactory. The net book value of Lano's and its subsidiaries' property and equipment at June 30, 1969 was approximately $2,200,000.

Services Group

(A) **Yellow Cab Co. of Louisville**

(B) **Southern Cab Corporation**

(A) **Yellow Cab Co. of Louisville.** Yellow Cab and its predecessor, Louisville Taxicab and Transfer Company, have provided personal transportation service to residents of Louisville, Kentucky, since the Civil War period. Yellow Cab operates approximately 230 taxicabs under permit from the Commonwealth of Kentucky, offers airport and limousine service, and is the largest taxicab company in Kentucky. All cabs are equipped with two-way radio service. In addition, Yellow Cab maintains a package delivery and an ambulance service, and also operates a driver training school under license from the Commonwealth of Kentucky. In 1968 approximately 1,500 persons received driver training at Yellow Cab's school.

Yellow Cab's fleet has an average age of 2 years and is well maintained. In February of 1968, Yellow Cab sold its garage and office buildings to the Urban Renewal and Community Development Agency of Louisville. It is now leasing the facility from the Urban Renewal Agency pending completion of a new garage and office building on a four acre site in Louisville owned by Yellow Cab. Yellow Cab has approximately 500 employees including 415 full and part-time drivers who are paid on a commission basis.

(B) **Southern Cab Corporation.** Southern Cab has two operating divisions, Yellow Cab Company of Memphis ("Memphis-Yellow") and the B-Line Cab Company ("B-Line"). Memphis-Yellow is engaged in the rental of taxicabs to independent publicly licensed drivers on a fixed per diem rental charge. It maintains approximately 90 vehicles for hire under permit from the City of Memphis and provides the independent drivers with a two-way radio dispatch call service and reserved taxicab stands at various public places. All fares collected by the drivers are retained by them in their individual capacities. Memphis-Yellow's earnings are received solely from the rental of vehicles and the providing of related services to drivers. Memphis-Yellow owns a garage and office building containing 10,000 square feet on a 1½ acre parcel. Memphis-Yellow has approximately 30 full-time non-driver employees. Memphis-Yellow competes with two companies of similar size which rent taxicabs in the Memphis area.

B-Line operates approximately 65 taxicabs in Louisville, Kentucky, all of which are equipped with two-way radios. It employs approximately 90 persons, including 70 full and part-time drivers who are paid on a commission basis. B-Line leases its garage and office facility. The vehicle fleet of both divisions of Southern Cab Corporation have an average age of two years and are well maintained.

In the opinion of the management of the Services Group companies, the relations of each company with its employees are satisfactory.

BUSINESS AND PROPERTIES OF TSC

TSC Industries, Inc. ("TSC") was incorporated under the law of Delaware in November 1967 for the purpose of succeeding by merger to its predecessors, Tractor Supply Co. and Community Discount Centers, Inc., Illinois corporations. The merger became effective February 19, 1968, and pursuant thereto TSC succeeded to all of the existing assets and became liable for all of the existing obligations of Tractor Supply Co. and Community Discount Centers, Inc., respectively. Immediately after the merger TSC transferred the business and substantially all the assets owned by the predecessor Community Discount Centers, Inc. to a newly organized wholly-owned Delaware subsidiary of TSC, also named Community Discount Centers, Inc., and the new Delaware subsidiary assumed substantially all of the existing liabilities of Community Discount Centers, Inc. (the Illinois corporation) existing at the time of the merger. TSC, as the parent company, has authorized its guarantee of all trade obligations of such Delaware subsidiary as well as various other mortgage and lease obligations of its subsidiaries. Unless the context otherwise requires the term "TSC" means TSC and predecessors and subsidiaries collectively.

TSC is a retail merchandiser, with its executive offices located at 4747 North Ravenswood Avenue, Chicago, Illinois 60640. TSC operates two main retail divisions:

Tractor Supply Division (Tractor Division) sells repair and replacement parts, attachments, accessories and supplies for farm machinery, and a variety of other products for use on the farm. This division also sells a substantial number of non-agricultural products, including automotive supplies, tires and tubes, building supplies, lawn and garden products, wearing apparel and housewares. Tractor Division sells its products through 173 retail stores, including five franchise stores, in 28 states and in three provinces of Canada and by mail order.

Community Discount Centers, Inc. (Community Division) sells a broad variety of wearing apparel, textile products, housewares, sporting goods, toys, records, automobile supplies and other consumer items. It operates 36 self-service retail stores in five states, of which 24 stores are located in the Chicago metropolitan area. In addition, it operates 12 sporting goods stores and departments.

The approximate percentage contributions by the Tractor Division and Community Division (excluding the non-consolidated Mages Sports Arenas, Inc.) to the results for fiscal 1968 and for the first nine (9) months ended July 31, 1968 and 1969 were as follows:

	Fiscal 1968	Nine Months Ended July 31, 1968	Nine Months Ended July 31, 1969
Net sales			
Tractor Division	35%	34%	38%
Community Division	65%	66%	62%
Net income before provision for federal income taxes and extraordinary items and before certain common corporate expenses			
Tractor Division	61%	51%	92%
Community Division	39%	49%	8%*

* See Consolidated Statement of Income of TSC for a brief explanation of the reduction of net income relative to the Community Division.

Tractor Division

General

Tractor Division's principal business is the sale to farmers of repair and replacement parts, attachments, accessories and supplies for farm machinery, and a substantial number of other product lines including material handling equipment; animal and dairy supplies such as feeders, waterers, feed supplements, animal pharmaceuticals and sprays; and fencing and wire products. This division also sells several important lines of non-agricultural merchandise, including automotive supplies, tires and tubes; hand and portable power tools; building supplies; lawn and garden items; wearing apparel and housewares. In excess of 15,000 different items are available through the division's stores or are listed in its mail order catalog.

Tractor Division sells its products through 168 retail stores and five franchise stores located in 28 states and in three provinces of Canada, and by mail order. The retail stores are divided into two groups, of which 127 are known as "Tractor Supply Co. Stores" or "TSC Stores," 40 as "Big Bear Stores" or "SAS Stores," and one as "Robertson's Farm Supply." As Tractor Supply Co. Stores are remodeled or relocated they are renamed as TSC Stores, and new stores added to this group are named TSC Stores. The SAS Stores are being renamed as Big Bear Stores over an extended period.

Tractor Division maintains warehouses in Indianapolis, Indiana, Omaha, Nebraska, St. Cloud, Minnesota, and Aberdeen, South Dakota.

The great majority of Tractor Division's farm machinery parts are designed and manufactured by others for use interchangeably with replacement parts available from manufacturers of the original equipment. Tractor Division also sells parts and attachments of its own design which extend the utility or function of the original equipment with which such items may be used.

Tractor Division has over 800 suppliers of its merchandise. No single supplier accounted for more than 7% of Tractor Division's purchases during fiscal year 1968. The majority of Tractor Division's farm

machinery parts suppliers are also suppliers to manufacturers of original equipment in the farm machinery, automotive and truck fields.

Each of the stores operating under the Tractor Supply or TSC name sells a similar line of merchandise. Variations in the stock of such stores reflect differences in customer requirements in the respective farm territories served by them. The sale of repair and replacement parts for farm machinery constitutes a much smaller part of the sales of the Big Bear and SAS group of stores than of the Tractor Supply and TSC group of stores in general.

Demand for Tractor Division products is heaviest during the months of March through October, and inventory levels in its warehouses and stores vary accordingly.

Tractor Division also sells and constructs pole-type buildings for farm and industrial use. It sells and constructs prefabricated buildings for cattle, hogs and poultry with automatically controlled feeding and temperature mechanisms. It also manufactures spindles for mechanical cotton harvesters, cylinder sleeve assemblies, manifolds, cylinder blocks, pumps and air compressors.

In February 1967 all of the outstanding shares of Big Bear, Inc., a retailer of expendable farm supplies through 17 stores in Minnesota and Iowa, were acquired in exchange for the equivalent of 60,000 common shares of TSC issued at the closing and a total of 29,923 common shares of TSC issued in December 1967 and February 1968. In April 1968 all of the shares of SAS, Inc., a retailer of expendable farm, ranch and home supplies with nine stores and two warehouses in North Dakota and South Dakota, were acquired in exchange for 73,000 shares of TSC Convertible Stock issued at the closing and a total of 47,000 additional such shares issued on February 27, 1969 and October 23, 1969.

Marketing and distribution

Tractor Division's principal market consists of mechanized commercial farms. Most stores are in the corn-belt, wheat-belt and cotton-belt states. Sales are made over-the-counter and by mail order. Approximately 90% of Tractor Division's sales are made on a cash or C.O.D. basis. Credit sales are made principally under a revolving-credit type program and have been expanding in recent years. Tractor Division carries all but a minor part of its customer receivables. Collections on credit sales have been good.

The total number of Tractor Division's stores (excluding franchise stores) in operation at the end of each of the last five fiscal years and as of July 31, 1969 is as follows:

	October 31					July 31,
	1964	1965	1966	1967	1968	1969
Number of stores	100	107	113	141	162	168

No stores were closed during the five-year and nine month period. As indicated by the table, a number of new stores were opened and some existing stores were acquired during the period, which have made substantial contributions to sales and net income. In addition, during the period, a number of stores have been modernized and some have been moved to better and larger locations, with a very satisfactory effect on the performance of those stores. These changes are a part of a program of broadening merchandise lines, with particular attention to increasing the penetration of the non-farm market.

Presently 21 locations for new or relocated stores are either planned or under construction. New stores which are being opened and relocated stores are being designated "TSC" stores rather than "Tractor Supply Co." stores, in recognition of the fact that the lines of merchandise offered in such stores are now much broader than they were a few years ago in that they include lines for the non-farm markets.

Tractor Division has also franchised the operation of five independently owned stores under the name "TSC", of which four are presently in operation. Additional stores may be franchised in some farm areas in cases in which the profit potential for a store in a particular area appears to be favorable.

Availability of merchandise and favorable pricing are key factors in the success of Tractor Division's sales program. Most farms are equipped with machinery of many different makes. Through the maintenance of stocks of parts for many makes and models of equipment in its branch stores and warehouses, the Tractor Division is able to service the farmer or mechanic who needs parts or service for machines of various makes. Another significant aspect of Tractor Division's sales program is that it has from its inception in 1938 refrained from stressing manufacturers' brand names or factory warranties. Rather, it has used, for the most part, private brand names, and its customers have come to rely upon Tractor Division's reputation for quality merchandise.

Parts, attachments, accessories and supplies for farm machinery tend to enjoy a relatively stable demand, reflecting more the amount of machinery in use than the volume of sales of new machinery. The fact that farm machinery tends to have a substantially longer useful life than automobiles or trucks also contributes to the stability of the demand for Tractor Division's products.

Tractor Division believes that its methods of operation and the breadth of its line of products enables it to compete broadly in the market for parts for farm machinery. However, it experiences competition in a variety of forms which is substantial in the aggregate. The major farm equipment manufacturers have numerous local dealers who sell new machinery and who also sell replacement parts and attempt to secure service and maintenance business for machinery already in use. This competition is most effective for comparatively new machines, particularly during a warranty period, and also with farmers who require full shop service for maintenance. As farm machinery ages, however, farmers tend to service their own equipment, increasing the sales potential for Tractor Division. In its other product lines Tractor Division has competition from a variety of automotive dealers and supply stores, hardware stores, mail order houses, farm supply outlets, farm cooperatives, and to some extent from major chains and department stores.

Community Division

General

Community Division operates 36 retail self-service stores, called "Community Discount Centers", located as follows: 12 in the city of Chicago; 12 in suburbs of Chicago; five in the metropolitan Kansas City area of Missouri and Kansas; and one in each of Aurora and Decatur, Illinois; St. Joseph, Missouri; Kenosha and Racine, Wisconsin; and Gary and Highland, Indiana.

Community Division also operates twelve other retail outlets as follows: two sporting goods stores in the Chicago area under the name "Mages Sporting Goods Stores", four sporting goods stores and five leased sporting goods departments in the Philadelphia area under the name "M & H Sporting Goods Company", and a marine mart in Chicago. In addition, this division has two bowling centers in the Chicago area.

Community Division competes vigorously with many other retailers, including discount stores, department stores, mail order stores and specialty stores, and its share of consumer goods sales in the areas in which its stores are located is relatively small.

The percentages of total sales in the Community Division stores by Community Division and by its concessionaires were as follows for the periods stated:

	Percent		Percent Nine Months Ended	
	1967	1968	July 31, 1968	July 31, 1969
By Community	72%	75%	75%	74%
By concessionaires	28%	25%	25%	26%

In October 1967 most of the assets of 15 stores (including one store then under construction) being operated in Illinois, Indiana and Missouri under the name "Shoppers World" were acquired from Aldens, Inc. and its subsidiaries for $10,310,000. In April 1968 certain of the assets of five department stores located in Kansas City, Missouri and Kansas City, Kansas, and operated under the name "Gamble Department Stores" (and sometimes referred to herein as the "Kansas City Stores") were acquired from Gamble Skogmo, Inc., the corporate parent of Aldens, Inc., for $2,400,000. During the year ended October 31, 1968 the Shoppers World and Gamble Stores were converted to Community stores in both operation and name.

The Community Discount Centers

The Community Discount Centers sell a broad variety of consumer merchandise at prices which are generally lower than prevailing retail prices for comparable merchandise. They concentrate on lower and middle priced lines of merchandise and operate on a self-service basis with check-out stands to minimize labor costs. Customers pay cash or use bank credit cards and carry merchandise purchased. Each store has departments selling men's, women's and children's apparel, textile products, housewares, sporting goods, toys, records, paper products, and miscellaneous products for use in automobiles. The stores are located in neighborhood and outlying shopping areas and cater to low to middle income groups. The stores are usually open ten to twelve hours a day, seven days a week, and generally provide parking facilities.

The Community Discount Centers generally have followed the policy of leasing the drug, restaurant, millinery, shoes, furniture, jewelry, paint and hardware, and garden and nursery products departments to concessionaires in the belief that concessionaires can operate these departments more efficiently. However, the paint and hardware departments and all but two of the drug departments of the former Shoppers World stores are operated directly, and Community Division intends to commence direct operation of the other paint and hardware departments and the drug departments as the concession leases expire. All stores have two or more concessionaire operated departments. The concessionaries sell designated lines of merchandise under one to ten year agreements with Community, for which they are obligated to pay to Community percentages ranging between five and eleven per cent of their sales (in most cases subject to minimal annual payments).

More than half of the sales of Community Discount Centers in each of the five years ended October 31, 1968 were accounted for by wearing apparel and other soft lines including textiles.

During the last five fiscal years, Community Division added 25 large stores, including the 15 Shoppers World Stores, and the five Gamble department stores in Kansas City, and has closed three unprofitable stores. In addition one small store was destroyed by fire in April 1968, and one unprofitable store was closed during February, 1969.

Sporting goods stores

The two Mages and the nine M & H stores and departments retail extensive lines of sporting, leisure-time and recreational goods and equipment. They also carry limited selections of photographic equipment, bicycles and toys. Substantially all of the sporting goods offered for sale bear nationally advertised and established brand names.

During the five years ended October 31, 1968, the number of sporting goods stores and departments (including the marine mart) declined from 22 to 14 and their percentage of sales of Community Division, including leased departments, declined from 9% to 3%. The business of these stores has not been profitable in the aggregate during the past five years. In recent years increased competition from department stores and mail order stores has adversely affected specialty sporting goods stores.

The two Mages stores are leased at an aggregate annual rental of $25,200. One lease expires in 1970 and the other lease in 1973. Community Division intends to close these stores as their leases expire.

The marine mart sells small boats and boat motors and accessories. Its sales are an insignificant part of Community Division's total business.

Bowling centers

Community Division's wholly-owned non-consolidated subsidiary, Mages Sports Arenas, Inc., owns the equipment in and operates two 48-lane bowling centers in the Chicago area in premises occupied under leases which expire in 1979 and 1980. One of the centers was opened in 1959 and the other in 1960. The operation of the bowling centers has not been profitable. During the past five fiscal years ended October 31, net losses have ranged from $85,000 in 1966 to $17,000 in 1968.

Employees

At September 30, 1969 TSC had approximately 4,400 employes (not including seasonal help), of which approximately 1,300 worked in the Tractor Division and 3,100 in the Community Division. Most of TSC's employees are eligible for contributory major medical plans and non-contributory group life insurance. Certain employees of the Tractor Division participate in a contributory pension plan and a non-contributory stock bonus plan. Community Division contributes to a union-operated pension plan for its union employees. TSC believes that its employee relations are satisfactory.

PROPERTY

Property used by Tractor Division

TSC owns the building in Chicago in which the executive offices of TSC and the general offices of the Tractor Division are located. This building is of fire resistant brick construction and contains approximately 110,000 square feet of usable space on four floors and basement. The TSC and Tractor Division offices occupy approximately 50,000 square feet. An additional 35,000 square feet is presently being converted from warehouse space to office space to house the Community Division general offices. The balance is occupied by the Community Division as warehouse space.

Most of Tractor Division's other properties are leased from others. Of the space occupied by the Tractor Division prior to 1965, TSC owned only the Chicago building, the space occupied by four of its stores and a small manufacturing plant. In 1965 TSC began purchasing the land and buildings occupied by the Tractor Division stores and sites for new stores in cases where conditions were favorable. In addition to the Chicago building, a warehouse and a small manufacturing plant, TSC now owns the land and buildings occupied by 30 of the Tractor Division stores, a portion of the facilities occupied by 2 other stores, 15 sites where new stores are either planned or under construction, and the property utilized in connection with its pole-type buildings construction and sales operation. Certain of the Tractor Division properties are mortgaged to secure indebtedness of an aggregate amount of $2,218,352 at July 31, 1969, maturing in 1971 through 1989 and bearing annual interest at 5% to 7¾%.

All other stores, warehouses and facilities are occupied under leases. Leases expire as follows:

Fiscal Year	Number of leases	Fiscal Year	Number of leases
1970	53	1976	4
1971	17	1977	2
1972	27	1978	9
1973	16	1979	2
1974	7	1980-89	13
1975	8		

Current aggregate annual rental for leased space is approximately $1,074,586. During the last three years Tractor Division has relocated 26 of its stores in the same towns in enlarged and improved facilities and has expanded 19 existing store facilities. Tractor Division's stores range in size from approximately 3,200 to 33,000 square feet.

Property used by the Community Division

Of the 48 retail outlets of Community Division, five are leased departments, seven are retail stores located on premises wholly owned by the Community Division and 36 on premises leased from others. Premises occupied by Community Division have approximately 2,285,000 square feet of floor space, of which approximately 630,000 are in premises owned by the Community Division and approximately 1,655,000 are in premises occupied under leases. Approximately 50,000 square feet are used for office space. Approximately 110,000 square feet consist of warehouse space leased to others. The Community Division outlets have selling space ranging from approximately 2,000 to 100,000 square feet.

Of the 36 Community Division stores occupied under lease from others: 12 are under fixed annual rentals aggregating $766,000 and 24 are under percentage of sale rentals ranging between 1% and 4½%, with minimum annual rentals aggregating $2,288,000; during the past five fiscal years only minimum rentals have been payable except on a lease for one small store with a low minimum rental. The five leased departments are under rentals of 10% of sales. In addition, a parking lot is leased at an annual rental of $6,000. The Community Division assumes some or all of the occupancy, maintenance and property tax expenses on the leased properties of Community Division.

The leases on the two bowling centers expire in 1979 and 1980, subject to renewal options of the lessee. They provide for minimum annual rentals of $60,000 and $40,000, respectively, and for certain percentage rentals which have not been applicable thus far.

Leases for the retail stores expire as follows:

Year	Number of stores	Square feet of space	Fixed or minimum annual rentals
1970	3	16,900	$ 28,800
1971	6	52,000	102,500
1972	1	18,000	7,200
1973	1	5,000	9,000
1974-93	25	1,550,000	2,906,500
Totals	36	1,641,900	$3,054,000

The properties owned by the Community Division are held subject to mortgages and building contracts securing indebtedness with principal balances of approximately $1,537,987 at July 31, 1969, maturing in 1970 through 1982 and bearing annual interest at 6% to 8%.

In connection with the purchase of the Shoppers World and Gamble Department Stores assets and as security for the performance by TSC of the lessees' obligations under the leases of the stores properties, TSC (i) granted to the sellers a continuing security interest in specified store assets purchased, consisting principally of leasehold improvements, fixtures, furniture and equipment in the stores and similar assets substituted therefor (the Collateral), and (ii) conditionally reassigned to the sellers all of the lessees' interests under the stores leases, such reassignment to become effective with respect to any given lease at the election of the sellers following an event of default, as defined, in the performance of the lessees' obligations thereunder. The security interest in the Collateral and the conditional reassignment of the leases are to remain in effect so long as the sellers remain liable as guarantor or otherwise under the leases, provided that the rights of the sellers against the Collateral

shall be suspended so long as TSC's consolidated book net worth, as defined, is $15,000,000 or more during the period ending October 27, 1972, or $10,000,000 or more thereafter, subject to reinstatement whenever such consolidated book net worth falls below the applicable specified amount. In addition, if such net worth should decline below $15,000,000 during the period ending October 27, 1972, the persons liable for the lease obligations would be required to make a deposit of collateral in the amount of $1,000,000 or its equivalent. At all times since the merger of Tractor Supply Co. and Community Discount Centers, Inc. into TSC, the consolidated book net worth has been in excess of $15,000,000. At July 31, 1969, consolidated book net worth was $25,181,972.

MANAGEMENT OF NATIONAL

Directors

The names of the Directors of National, their present principal occupations, and other pertinent information concerning them, are as follows:

Name and Principal Occupation	Year First Elected As Director of National	Shares of National Common Stock Beneficially Owned at October 10, 1969(1)
Bernard H. Barnett(2) Chairman of the Board of National since 1964; Partner—Law firm of Greenebaum, Grissom, Doll, Matthews & Boone for more than five years prior to the date hereof	1964	229,882
James F. Breuil Oil and gas consultant; President of Kingwood Oil Company (oil producer) for more than five years prior to 1965	1965	637,240
John J. Cott President of Cott Corporation for more than five years	1968	3,560
Ralph M. Cronin Vice President of National since 1964	1965	2,047
Roger Elton President of the National Division at Franklin National Bank for the past five years	1968	255
J. A. Gammon(2) Vice President-Transportation of National since September, 1966; President, Louisville Taxicab and Transfer Company and Southern Tank Lines, Inc. for more than five years prior thereto	1966	103,020
J. Howard Marshall Private Investor; President of Union Texas Petroleum, a division of Allied Chemical Company, for more than five years prior to 1968	1966	148,402
Charles F. Simonelli(2) Executive Vice President of National; prior thereto employed by Technicolor, Inc. as Executive Vice President and prior thereto as Corporate Vice President	1968	26,520
Grant Thomas President of American Synthetic Rubber Co. for more than five years prior to the date hereof	1963	6,698
Stanley R. Yarmuth(2) President and Chief Executive Officer of National since 1963	1963	518,789

(1) Where applicable, includes shares owned by wives and as custodian for minor children.
(2) Member of Executive Committee.

None of the persons named above own any shares of National Series A or Series B Preferred Stock.

In addition to the above holdings, certain Directors owned National's 5¾% Convertible Subordinated Debentures Due 1988 in the following amounts—Mr. Cott $50,000; Mr. Cronin $20,000; Mr. Simonelli $100,000; and Mr. Yarmuth $50,000; Mr. Marshall owned 5,100 and Mr. Yarmuth owned 3,000 Warrants to purchase an equivalent number of shares of National's Common Stock. None of the Directors owned any other securities of National or of TSC.

At October 10, 1969 the Directors owned beneficially the following shares of Common Stock of General Nursing Homes Corporation—Mr. Barnett 14,700 shares, Mr. Simonelli 1,500 shares, Mr. Gammon 200 shares, and Mr. Yarmuth 33,591 shares.

REMUNERATION OF AND OTHER TRANSACTIONS WITH DIRECTORS AND OFFICERS

The following table sets forth the aggregate remuneration for services in all capacities paid by National and its subsidiaries during the fiscal year ending December 31, 1968 on an accrual basis to each director and to each of National's three highest paid officers whose aggregate remuneration exceeded $30,000, and to all directors and officers of National:

Name of Individual or Identity of Group	Capacities in Which Remuneration Received	Aggregate Direct Remuneration
John J. Cott	President of Cott Corporation	$ 45,333.40
Ralph M. Cronin	Vice President—Corporate Communications of National, Executive of various subsidiaries	$ 32,104.17
Alvin H. Einbender	Chairman of the Board of Retail Centers	$ 60,000.00
J. A. Gammon	Vice President—Transportation of National, Chairman of the Board of Southern Tank Lines and Chief Executive Officer of the taxicab subsidiaries	$ 50,000.00
Seymour B. Orner	Chairman of the Board of LaSalle National Insurance Company	$ 50,000.00
Stanley R. Yarmuth	President of National, Executive and Director of various subsidiaries	$ 78,800.00
All Directors and Officers as a group (21 in number)		$556,779.31

The figures above for all officers and directors as a group do not include legal fees paid during 1968 of $52,965.21 by National to Greenebaum, Grissom, Doll, Matthews & Boone, a law firm of which Mr. Barnett is a partner.

National has a five year employment agreement effective February 14, 1969 with Mr. Simonelli entitling him to an annual salary of $50,000. In addition, National has transferred 13,260 shares of Common Stock to Mr. Simonelli in consideration for services to be rendered to the Company. An additional 13,260 shares have been sold to Mr. Simonelli at a price of $21.00 per share, and he has executed to National a non-interest bearing note for the purchase price thereof. The 13,260 shares have been pledged as security for payment of the Note. However, Mr. Simonelli has no personal liability regarding any unpaid balance. National holds as depository the 26,250 shares which are subject to several restrictions. Mr. Simonelli's agreement provides in part that he must complete two years' employment with National or all of the shares will be returned and forfeited to National and the Note will be cancelled. Thereafter, the restrictions are removed from such shares in annual installments of one-third each, irrespective of whether Mr. Simonelli is then employed by National.

Mr. Cott has an eight year employment agreement with National's subsidiary, Cott Corporation, effective June 1, 1969 entitling him to an annual salary of $50,000.

Mr. Orner was a participant in the LaSalle Employees' Retirement Plan effective January 1, 1967. During 1968 $6,759 was set aside or accrued under such plan for Mr. Orner, and his estimated annual benefit upon retirement is $7,500. Mr. Cott is a participant in the Cott Retirement Plan effective April 1, 1969. His estimated annual benefit upon retirement is $19,000.

The National Industries, Inc. Pension Plan was established on June 1, 1969. Estimated annual retirement benefits payable under said plan upon retirement will be $28,600 to Mr. Yarmuth, $5,500 to Mr. Cronin, $16,600 to Mr. Simonelli, and $130,000 to all officers and directors of National as a group consisting of 10 persons.

National has inaugurated an Incentive Compensation Program which is entirely discretionary. It is estimated that the incentive awards payable on the basis of performance during 1969 to officers and employees of National and its operating subsidiaries will not exceed $250,000.

In 1968, Globe Acceptance Company, a wholly-owned subsidiary of National, loaned to Mr. Ivan Greenspan and Mr. Joseph Henehan, officers of National, the sum of $51,071.88 and $10,014.38, respectively, which balances are still outstanding. Each promissory note is due on demand, bears interest at the rate of 6½% per annum and is secured.

During 1968, Mr. Breuil contributed $2,510 to Kingwood Oil Company (a wholly-owned subsidiary of National) as his proportionate share of the operating expenses incurred by Kingwood in connection with a leasehold estate in Jack County, Texas, in which Mr. Breuil and Kingwood each own an undivided one-half interest. Mr. Breuil acquired his interest in this leasehold estate from Kingwood in 1955. During 1968, Mr. Breuil's income from this lease amounted to $9,396. Mr. Breuil received $9,120 of income during 1968 from a leasehold estate located at Camp Breckinridge, Morganfield, Kentucky, in which Kingwood holds a 75% interest and Mr. Breuil a 10% interest, Mr. Breuil having acquired his interest from Kingwood in 1959. During the same period of time Mr. Breuil contributed $6,874 as his proportionate share of operating expenses. During 1968 Mr. Breuil contributed to Kingwood $14,580 as his proportionate share of the operating costs incurred by Kingwood in the operation and development of a waterflood of certain leasehold estates located in Hamilton County, Illinois, in which Kingwood holds an 11/16 interest and Mr. Breuil a ⅛ interest, Mr. Breuil having acquired his interest from Kingwood in 1940. During 1968, Mr. Breuil received income of $69,355 from his interest in this last leasehold estate. During 1968, Mr. Breuil participated to the extent of 25% with Kingwood in the Kirschner Well located in Oklmulgee County, Oklahoma. He had income during 1968 from such well of $2,960 and incurred operating and equipment expenses of $4,020 in connection therewith. He also participated with Kingwood to the extent of 12½% in the White Well located in Blaine County, Oklahoma, and during 1968 incurred operating and equipment expenses of $491 while receiving income of $1,500 from such well. During 1968, Mr. Breuil received $7,757 of income from a leasehold estate located in Clay County, Illinois in which Kingwood owned a ⅞ interest and Mr. Breuil a ⅛ interest, Mr. Breuil having acquired his interest from Kingwood in 1942. During the same period of time, Mr. Breuil contributed $2,697 as his proportionate share of operating expenses of the Clay County, Illinois project. During 1968, Mr. Breuil contributed to Kingwood $1,470 as his proportionate share of the operating costs incurred by Kingwood in the operation of a waterflood on certain leasehold estates in Henderson County, Kentucky in which Kingwood owned a 92.8% interest and Mr. Breuil a 7.2% interest, Mr. Breuil having acquired his interest from Kingwood in 1950. During 1968 Mr. Breuil received income of $3,840 from his interest in this last leasehold estate.

The property on which the 102,000 square foot Cincinnati store of G°E°S is operated is leased from four corporations for a term expiring January 31, 1988 at a net annual rental of $105,000. Mr. Einbender is the owner of all of the stock of one of the corporations which has a 25% interest in the property. National's home offices are located in the Bank of Louisville Building in Louisville, Kentucky. National and subsidiaries rent total office space of approximately 16,000 square feet in such building at an annual rental of $62,700. Messrs. Yarmuth, Barnett and Einbender each owns a 25% interest in a joint venture which owns this property. Management of National believes each of the rentals to be competitive and reasonable considering comparable rentals in the respective cities.

In connection with the merger of Retail Centers into National in July of 1968, Mr. Yarmuth, Mr. Breuil, Mr. Einbender and Mr. Marshall received 2,242, 7,382, 2,134 and 1,414 shares of National's Common Stock, respectively. Mr. Einbender also owned 228,000 of 5¾% convertible subordinated debentures of Retail Centers which were assumed by National in the merger. These debentures were subsequently called for redemption and were converted into Common Stock by Mr. Einbender.

National maintains certain of its accounts and has engaged in borrowing transactions with Franklin National Bank, New York, New York. Mr. Elton, a Director of National, is President of the National Division of said Bank. Franklin National Bank also acts as transfer agent for National and has acted as exchange agent in connection with various mergers during 1968.

For transactions involving the cancellation and reissuance of qualified stock options, see "Stock Options" below.

Stock Options

Stock options have been granted to officers, Directors and key employees of National and its subsidiaries pursuant to National's Qualified Stock Option Plan (the "National Plan"). The National Plan is intended to qualify for the favorable tax treatment accorded to "Qualified Stock Option Plans" under the provisions of Sections 422 and 424 of the Internal Revenue Code of 1954, as amended. The National Plan covers an aggregate of 406,000 shares. The National Plan provides for the granting of options to key employees of National and its subsidiaries to purchase Common Stock of National at a price of not less than 100% of the fair market value of such stock on the date of grant, as determined by the Board of Directors. Each option expires five years from the date of grant.

At October 10, 1969 options for 320,213 shares under the National Plan were outstanding. On the same date an additional 85,787 shares were available for grant of options under the National Plan.

The following tabulations show as to certain directors and officers and as to all directors and officers as a group (i) the amount of options granted by National between January 1, 1968 and October 10, 1969, (ii) the amount of shares acquired in such period through the exercise of options granted during such period or prior thereto, and (iii) the amount of shares subject to all unexercised options held as of October 10, 1969. No such shares have been sold as of October 10, 1969.

Shares of Common Stock(1)	John J. Cott(3)	Ralph M. Cronin	Seymour B. Orner	Alvin H. Einbender	All Directors and Officers As A Group(3)
Granted—January 1, 1968 to October 10, 1969:					
Number of Shares	10,200	1,000	—	(2)	24,985
Average per share option price	$10.00	$10.00	—	(2)	$10.00
Exercised—January 1, 1968 to October 10, 1969:					
Number of Shares	—	—	3,000	—	3,000
Aggregate option price of option exercised	—	—	$5.50	—	$5.50
Aggregate Market Value	—	—	$67,125	—	$67,125
Unexercised at October 10, 1969:					
Number of Shares	10,200	8,140	12,240	30,982	91,177
Average per share option price	$10.00	$5.83	$4.98	$5.93	$6.12

(1) Number of shares and prices per share have been adjusted to reflect the 2% stock dividend paid in February, 1969.

(2) In connection with the merger of Retail Centers into National of July 1, 1968, National assumed all outstanding employee stock options of Retail Centers as of the date of the merger. As a result, Mr. Einbender,

who, as of July 1, 1968 held options to purchase 15,750 shares of Common Stock of Retail Centers at an option price of $3.81 per share, became entitled to purchase 7,875 shares of National Common Stock.

(3) In August, 1969, National canceled 10,200 of its outstanding qualified stock options previously issued to Mr. Cott at a price of $20.52 and on September 17, 1969 reissued options to purchase 10,200 shares of Common Stock to him at a price of $10.00 per share. Also in August, 1969, two other officers of National had 3,315 options canceled which had an average exercise price of $15.22 per share. On September 17, 1969 these officers received an equivalent number of options in addition to other options to purchase shares of Common Stock of National at a price of $10.00 per share.

DESCRIPTION OF CAPITAL STOCK

National—Authorized Capital Stock

The authorized capital stock of National is (a) 12,000,000 shares of Common Stock, par value $1.00 per share, and (b) 5,000,000 shares of Preferred Stock, par value $1.00 per share. The Board of Directors of National is authorized without any further action by the shareholders, to divide the Preferred Stock into series, to fix the number of shares constituting any series, and with respect to any such series, to fix the dividend rate, the price at, and the terms and conditions on which, the shares may at the election of National be redeemed, and to fix the terms and conditions on which the shares may be converted in the event the shares are issued with the privilege of conversion and the amount payable upon shares in the event of voluntary or involuntary liquidation. The Board of Directors of National has created and authorized the issuance of a series of Preferred Stock entitled $.60 Series A Cumulative Convertible Preferred Stock in an aggregate amount of 250,000 shares and a series of Preferred Stock entitled $1.25 Series B Cumulative Convertible Preferred Stock in an aggregate amount of 182,000 shares. If the TSC acquisition is consummated, it is estimated that an additional 1,500,000 shares of Series B Preferred Stock will be authorized by National's Board of Directors.

Dividend Rights

Holders of shares of the Series A Preferred Stock and the Series B Preferred Stock are entitled to receive annual cumulative cash dividends per share of $.60 and $1.25, respectively, before any dividends (other than dividends payable in shares of Common Stock) are paid to the holders of shares of Common Stock. Dividends on the shares of Series A Preferred Stock and Series B Preferred Stock are payable on the last days of March, June, September, and December in each year. Neither series of Preferred Stock has a preference in the payment of dividends over the other series. Dividends may not be paid on one series of Preferred Stock unless a proportionate dividend is concurrently paid on the other series. Accumulations of dividends will not bear interest. Subject to the foregoing, holders of shares of Common Stock are entitled to receive such dividends as may be declared by the Board of Directors of National. The total annual preferred dividend requirements are now approximately $311,000, and if the TSC acquisition is consummated will be approximately $1,530,000.

Under the terms of the indenture pursuant to which $25,000,000 of Convertible Subordinated Debentures of National, due 1988, were issued, for such time as any of such Debentures are outstanding, National will not, directly or indirectly, pay any dividend (except dividends payable solely in shares of stock of National) or make any other distribution on account of any of its Common Stock or redeem, retire, purchase or otherwise acquire, or permit any subsidiary to redeem, retire, purchase or otherwise acquire any shares of its Common Stock, if immediately after giving effect to such action, the sum of all such dividends, distributions, redemptions, retirements, purchases and other acquisitions paid or made during the period from December 31, 1967 to and including the date of such action would exceed the sum of (x) Consolidated Net Income accrued during such period, taken as a whole, (y) the net proceeds of the sale for cash after January 1, 1969 of Common Stock or preferred stock of the Company other than to a Subsidiary, plus (z) $3,000,000. The applicable provisions of the other Debentures or Loan Agreements of National are not as restrictive.

Voting Rights

All shares of Preferred Stock of both series, and all shares of Common Stock, are entitled to equal voting rights without regard to class or series on all matters upon which shareholders gen-

erally have the right to vote, including the election of directors. The Constitution of the Commonwealth of Kentucky provides for mandatory cumulative voting rights. If dividends on shares of Preferred Stock of any series are in default in an amount equivalent to six full quarterly dividends, the holders of shares of Preferred Stock will, in addition to their other voting rights, have the right (voting separately as a class and without regard to series) to elect two directors until the default is cured in full, in which event the membership of the Board shall be increased by two until the default shall be cured.

National may not, without the consent of the holders of two-thirds of the outstanding shares of Preferred Stock, regardless of series (i) create and issue any shares of any new class ranking, either as to payment of dividends or distribution of assets, on a parity with or prior to the Preferred Stock, (ii) change the preferences or rights of the Preferred Stock as a class, or (iii) increase the total number of authorized shares of Preferred Stock. If a particular series of Preferred Stock is affected adversely by a proposed change in the powers, preferences or rights set forth in the Certificate of Designation pertaining to such series, such change may not be effected without the consent of the holders of two-thirds of the outstanding shares of such series.

Redemption Provisions

The Series A Preferred Stock may be redeemed in whole or in part, at any time after five years after the date of issue, on at least 30 days' notice, at $31.50 per share and descending by $.375 per share each year thereafter until a price of $30 is reached, plus, in each case, accrued dividends. The Series B Preferred Stock may be redeemed in whole or in part, at any time, on at least 30 days' notice, at $26 per share. Redeemed shares will have the status of authorized but unissued shares and as such may be redesignated and reissued.

Sinking Fund

There is no sinking fund applicable to the shares of Preferred Stock.

Liquidation Rights

In the event of involuntary liquidation, the holders of Series A Preferred Stock and Series B Preferred Stock will be entitled to receive, before any payment to the holders of the Common Stock, $20 and $26 respectively, per share, plus accrued dividends. In the event of voluntary liquidation, the holders of Series A Preferred Stock and Series B Preferred Stock will be entitled to receive, before any payment to the holders of the Common Stock, the respective amounts which they would be entitled to receive if on the date of such liquidation their shares had been redeemed, or if the Series A Preferred Stock is not at the time redeemable, then $31.50 per share, plus, in each case, accrued dividends. The holders of shares of Common Stock are exclusively entitled to share ratably in the remaining net assets. Neither the merger or consolidation of National nor the sale, lease or conveyance of all or a part of its assets, is deemed to be a liquidation, dissolution or winding up of the affairs of National.

Preemptive Rights

Neither the Preferred Stock nor the Common Stock carries any preemptive or other rights to subscribe for or purchase any stock, obligations, warrants or other securities of National.

Conversion Rights

Each share of Series A Preferred Stock and Series B Preferred Stock is convertible at any time, at the option of the holder, into 1.4 share of Common Stock and 0.75 share of Common Stock, respectively. If any shares of Preferred Stock are called for redemption, such right of conversion will terminate on the sixth business day preceding the redemption date.

The rate at which shares of Series A Preferred Stock and Series B Preferred Stock are convertible into shares of Common Stock is subject to adjustment in case National (i) pays to the holders of Common Stock a dividend payable in shares of Common Stock, (ii) distributes to the holders of Common Stock any securities other than Common Stock or assets to the extent that in any consecutive 12 month period the value of such distribution or distributions exceeds 5% of the

market value of National Common Stock (as defined in the Certificates of Designation governing the particular Series); (iii) splits, reverse splits, or otherwise reclassifies the Common Stock; or (iv) issues rights or warrants to all holders of shares of Common Stock entitling them to purchase shares of Common Stock at a price per share less than the current market price.

No adjustment in the conversion rate is required if National otherwise issues shares of Common Stock or any security convertible into shares of Common Stock in exchange for cash, property or services, or if, at the same time as shares of Common Stock are issued as a dividend or distribution on the outstanding shares of Common Stock, shares of Common Stock are issued as an equivalent dividend or distribution on the outstanding Preferred Stock.

No adjustment in the number of shares of the Common Stock into which each share of Preferred Stock is convertible shall be required unless such adjustment would require an increase or decrease of more than 1/10th of a share in the number of shares of the Common Stock into which such share is then convertible; provided, however, that any such adjustments which are not required to be made shall be carried forward cumulatively and taken into account in any subsequent calculation.

Upon conversion, no payment or adjustment will be made for dividends on shares of stock converted. National will not be required to issue any fraction of a share of Common Stock on conversion, but appropriate adjustment will be made in cash based on current market value.

Reissue of Reacquired or Converted Shares of Preferred Stock

Shares of any series of Preferred Stock which have been retired or cancelled in any manner, including treasury shares retired, shares redeemed or converted into Common Stock have the status of authorized but unissued shares of Preferred Stock and may be reissued as shares of the series of which they were originally a part or as shares of any other or new series.

Personal Liability

The shares of all classes of outstanding stock or to be issued stock are (or, when issued, will be) fully-paid and non-assessable, with no personal liability attaching to the ownership thereof.

MATERIAL DIFFERENCES IN SHARES OF COMMON STOCK

1. Pursuant to the law of Kentucky, every National shareholder has the right in all elections for Directors of the Corporation to cumulatively vote their shares. This means that a holder of National shares of stock has the right to cast as many votes in the aggregate as he shall own shares of such stock, multiplied by the number of Directors to be elected at such election; and a shareholder may cast the whole number of votes for one candidate or distribute such votes among two or more candidates. The shareholders of TSC do not have such a right and are entitled to only one vote for each share held by such shareholders.

2. Under the law of Kentucky, if National were to authorize the sale, lease or exchange of all its assets, at a time when it is able to meet its liabilities then matured, any shareholder of National who filed with the corporation written objection thereto before the taking of the vote on such authorization (which authorization shall be by a vote of the holders of a majority of the voting power of all shareholders entitled to vote) and whose shares were not voted in favor of such corporate action may, at any time within 20 days after the date upon which such corporate action was authorized, demand in writing payment for his shares. No equivalent right exists for TSC shareholders, but such a sale, lease or exchange by TSC of its assets must be authorized by a majority of the outstanding stock of the corporation entitled to vote thereon.

3. Under the law of Kentucky, any merger involving a Kentucky corporation, such as National, must be approved by a majority of the outstanding voting securities of the Kentucky corporation, whether or not the number of shares such corporation issues in the merger is minimal. Under Delaware law, no vote of the stockholders of the corporation which is to survive a merger is required, if the merger will not change the shares of any class of that corporation's stock or otherwise amend its

certificate of incorporation, and if the agreement calls only for the issuance of previously authorized shares in a number which does not exceed 15% of the shares of the same class outstanding immediately prior to the merger.

4. There are no other material differences between the common stocks of both corporations.

DESCRIPTION OF WARRANTS OF NATIONAL

The National Warrants which will be issued to the shareholders of TSC will entitle the holders to purchase shares of National Common Stock for $21.40 per share during a period beginning on the Closing Date of the TSC acquisition and expiring on October 31, 1978. The purchase price and the total number of shares of National Common Stock issuable upon exercise are subject to adjustment in case of a stock dividend, split, reverse split or other reclassification of National Common Stock; or if rights or warrants are issued to all holders of shares of National Common Stock entitling them for a period of 45 days to purchase shares of National Common Stock at a price per share less than the current market price; or if any evidences of indebtedness or assets (other than cash payable out of consolidated earnings or earned surplus) are distributed to all holders of National Common Stock to the extent that in any consecutive 12-month period the value of such distribution or distributions exceeds 5% of the market value of National Common Stock (as defined in the National Warrant) during a specified period; or rights to purchase National's debt or equity securities (other than National's Common Stock) are distributed to all holders of National Common Stock. No adjustment will be required if National otherwise issues, in exchange for cash, property or services, shares of National Common Stock or any security carrying rights to acquire National Common Stock. No adjustment will be required unless such adjustment will require a decrease of at least $.50 in the purchase price, but any adjustments not made by reason of this provision will be carried forward and taken into account at the time of any subsequent adjustment.

If National consolidates with or merges into or sells its assets to another corporation, and National is not the continuing corporation in such consolidation, merger or sale of assets, a holder of a Warrant will be entitled to receive the securities or property to which a holder of the number of shares of Common Stock then deliverable upon the exercise of such Warrant and payment of the appropriate exercise therefor would have been entitled to receive upon such consolidation or merger.

Fractional shares of Common Stock will not be issued on exercise of Warrants, but National shall, in lieu thereof, either make a payment in cash based on the purchase price of the Common Stock purchasable upon the exercise of the Warrants, or issue scrip certificates (of such duration as determined by the Board of Directors) evidencing such fractional interests, which certificates may be combined and exchanged for whole shares of Common Stock of National.

Until a Warrant is exercised, its holder will not be entitled to any of the rights of a stockholder of National.

GENERAL

The cost of preparing, assembling and mailing this Proxy Statement, the Notice of Meeting, the enclosed form of Proxy and any additional material relating to the meeting which may be furnished to shareholders by the managements of National or TSC, subsequent to the furnishing of this Statement, will be provided or paid for by the respective corporations.

In addition to the solicitation of Proxies by use of the mails, each of the corporations may utilize the services of some of the officers and regular employees of the corporation (who will receive no compensation therefor in addition to their regular salaries) to solicit Proxies personally and by telephone and telegraph from brokerage houses and other shareholders. Each corporation intends to request banks and brokers who hold shares of the corporation's stock in their names or in custody, or in the names of nominees for others, to forward copies of the Proxy material to those persons for whom they hold such shares and to request authority for the execution of Proxies. Each corporation will reimburse such banks and brokers for their out-of-pocket expenses incurred in connection therewith. TSC and National have retained Georgeson & Co. to aid in the solicitation, at a fee (including its expenses) of $6,000 and $4,500, respectively.

PRO FORMA COMBINED BALANCE SHEET—Unaudited

The following unaudited pro forma combined balance sheet is based on the consolidated balance sheets of National at June 30, 1969, and TSC at July 31, 1969, and combined on a pro forma basis to reflect the National-TSC proposed transaction, which will be accounted for as a purchase. The pro forma combined balance sheet should be read in conjunction with the financial statements and notes thereto appearing elsewhere herein.

	(000 omitted)			
	National Industries, Inc. and Consolidated Subsidiaries	TSC Industries, Inc. and Consolidated Subsidiaries	Dr. (Cr.) Adjustments	National-TSC Pro Forma Combined
ASSETS				
Current Assets				
Cash and certificates of deposit	$ 12,091	$ 2,719		$ 14,810
Notes and accounts receivable	46,463	5,013		51,476
Inventories	45,310	43,997		89,307
Prepaid expenses	4,844	935		5,779
Total Current Assets	108,708	52,664		161,372
Investments	28,865	954	($ 1,191 (1)) ((23,969) (2))	7,041
Property and equipment, at cost less allowances for depreciation, depletion and amortization	60,962	14,539		75,501
Other Assets				
Notes and accounts receivable	12,859			12,859
Operating authorities and franchises	5,651			5,651
Sundry	4,814	766		5,580
Excess of cost of investments over underlying net assets of consolidated subsidiaries acquired	13,604			13,604
Unallocated cost of assets (3)			20,681 (2)	20,681
Future tax benefit arising from acquisition of TSC Industries, Inc. (4)			2,500 (2)	2,500
	$235,463	$ 68,923	$ 403	$304,789
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current Liabilities				
Notes payable	$ 16,649	$ 7,464		$ 24,113
Current maturities of long-term debt and convertible subordinated debt	21,406	1,372	$ (344) (1)	23,122
Accounts payable	31,188	13,323		44,511
Accrued expenses	9,573	3,493		13,066
Income taxes	3,039	992		4,031
Total Current Liabilities	81,855	26,644	(344)	108,843
Long-Term Debt, less current maturities	45,155	16,651	(847) (1)	62,653
Deferred Liabilities and Credits				
Income taxes	4,899			4,899
Deferred income	4,198	446		4,644
Convertible Subordinated Debt, less current maturities.	31,235			31,235
Stockholders' Equity				
National Preferred Stock, cumulative convertible, par value $1 a share:				
Series A, $.60	138			138 (6)
Series B, $1.25	182		(975) (2)	1,157 (6)
TSC Preferred Stock, par value $1 a share		913	913 (2)	—
National Common Stock, par value $1 a share	6,702			6,702
TSC Common Stock, par value $1 a share		1,852	1,852 (2)	—
Additional paid-in capital	35,860	9,225	(14,194) (2)	59,279
Retained earnings (5)	25,884	13,192	13,192 (2)	25,884
	68,766	25,182	788	93,160
Less cost of shares of Common Stock in treasury	645			645
	68,121	25,182	788	92,515
	$235,463	$ 68,923	$ (403)	$304,789

Notes:

(1) Adjustment to reflect the purchase by National from individuals, of 85,051 shares of the outstanding common stock of TSC at a price of $14 per share.

(2) Adjustments to reflect the purchase by National from TSC of substantially all of the assets of TSC, subject to all liabilities, for 1,498,000 shares, less 523,000 shares received by National in liquidation of TSC (treated herein as returned to the status of unissued shares), of National $1.25 Series B Preferred Stock. This stock will be issued on the basis of .6 share of National for each share of TSC Preferred outstanding and .5 share of National for each share of TSC Common outstanding. National will also issue 2,514,000 warrants (3,733,000 total issued, less 1,219,000 received by National in liquidation of TSC), each to purchase one share of National Common Stock at $21.40, in this transaction at a rate of 1.5 warrant for each share of TSC Common and 1 warrant for each share of TSC preferred. (See description of proposed transaction elsewhere herein.)

(3) Studies will be made to determine the extent to which the $20,948,000 should be allocated to various assets. National has not previously amortized amounts assigned to the excess of cost of investments over underlying net assets of consolidated subsidiaries acquired.

(4) The proposed transaction is expected to result in a capital loss of approximately $9,200,000 for federal income tax purposes. The effect which this loss may have on future taxes paid is approximately $2,500,000.

(5) At June 30, 1969 the Pro Forma Combined retained earnings of National, after giving effect to the purchase of TSC by National, not restricted as to the payment of cash dividends approximated $12,000,000.

(6) The aggregate involuntary liquidation value of the Series A and B Preferred Stock is $32,842,000.

(7) For additional information concerning National and TSC, see the audited financial statements of these companies included elsewhere herein.

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ACCOUNTANTS' REPORT

Board of Directors
National Industries, Inc.
Louisville, Kentucky

We have examined the consolidated balance sheet of National Industries, Inc. and consolidated subsidiaries as of December 31, 1968, and related statements of consolidated income and stockholders' equity for the three years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of four significant consolidated subsidiaries for 1966 and three significant consolidated subsidiaries for 1967, which were acquired by National Industries, Inc. in transactions accounted for as part-poolings of interest. Our opinion, insofar as it relates to amounts included for those subsidiaries whose financial statements we did not examine, is based solely upon the reports of other independent accountants which were furnished to us and which follow herein.

In our opinion, the accompanying consolidated balance sheet, statements of consolidated income appearing elsewhere herein, and statements of consolidated stockholders' equity of National Industries, Inc. and consolidated subsidiaries present fairly the consolidated financial position of National Industries, Inc. and its consolidated subsidiaries at December 31, 1968 and the consolidated results of their operations and the changes in stockholders' equity for the three years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

ERNST & ERNST

Louisville, Kentucky
March 14, 1969

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OPINIONS OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Shareholders
Cott Corporation

We have examined the statement of consolidated income of Cott Corporation and subsidiaries for the year ended April 30, 1967 and the related statements of consolidated capital in excess of par value and retained earnings for the year ended April 30, 1967. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We did not examine the financial statements of Nysco Laboratories, Inc. and affiliated companies included in the consolidated financial statements for the period from May 1, 1966 to March 21, 1967, but we were furnished with the report of other certified public accountants thereon.

In our opinion, based upon our examination and the report of other certified public accountants, the statements referred to above (not presented separately herein) present fairly the consolidated results of operations of Cott Corporation and subsidiaries for the year ended April 30, 1967 in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

TOUCHE ROSS & CO.

Boston, Massachusetts
March 1, 1968 as of June 21, 1967

To the Board of Directors and
Stockholders of Nysco Laboratories, Inc.

We have made an examination of the statements of earnings of Nysco Laboratories, Inc. and its affiliates for the period from May 1, 1966 to March 18, 1967. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements of earnings referred to above (not presented separately herein) present fairly the results of Nysco Laboratories, Inc. and affiliates' earnings for the period May 1, 1966 to March 18, 1967, in conformity with generally accepted accounting principles applied on a consistent basis.

SPIEGEL, WEISS AND COMPANY

Fords, New Jersey
April 27, 1967

OPINION OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of
Hawthorn-Mellody, Inc.

In our opinion, the consolidated statements of income and retained earnings of Hawthorn-Mellody, Inc. and subsidiaries (not presented separately herein) present fairly the results of their operations for the two fiscal years ended March 31, 1968, in conformity with generally accepted accounting principles consistently applied. Our examinations of the financial statements of Hawthorn-Mellody, Inc. for the two fiscal years ended March 31, 1968 were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

PRICE WATERHOUSE & CO.

Chicago, Illinois
May 29, 1968

ACCOUNTANTS' REPORT

To the Board of Directors
Crescent Corporation

We have examined the consolidated statements of income, other capital and retained earnings of Crescent Corporation (merged into National Industries, Inc. in 1968) and subsidiaries for the two years ended December 31, 1967. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements referred to above (not presented separately herein) present fairly the consolidated results of operations of Crescent Corporation and subsidiaries for the two years ended December 31, 1967, in conformity with generally accepted accounting principles applied on a consistent basis.

MAIN LAFRENTZ & CO.

Philadelphia, Pennsylvania
February 18, 1968 except
as to Note 4 dated
March 6, 1968 and
Notes 1 and 10 dated
March 12, 1968

To the Board of Directors
Royal School Laboratories, Inc.

We have examined the consolidated statements of income, other capital and retained earnings of Royal School Laboratories, Inc. (merged into National Industries, Inc. in 1968) and subsidiary for the two years ended December 31, 1967. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion the statements referred to above (not presented separately herein) present fairly the consolidated results of operations of Royal School Laboratories, Inc. and subsidiary for the two years ended December 31, 1967, in conformity with generally accepted accounting principles applied on a consistent basis except as stated in Note 1 of Notes to the financial statements in which change we concur.

MAIN LAFRENTZ & CO.

Philadelphia, Pennsylvania
February 16, 1968

NATIONAL INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31, 1968 Note A	June 30, 1969 (Unaudited) Note A
Current Assets		
Cash	$ 14,904,000	$ 11,441,000
Certificates of deposit and short-term commercial paper	13,072,000	650,000
Notes and accounts receivable—Note B	43,344,000	46,463,000
Inventories—Note C		
Raw materials and work in process	22,962,000	22,015,000
Finished goods	10,587,000	16,890,000
Merchandise	4,307,000	6,405,000
	37,856,000	45,310,000
Prepaid expenses	4,051,000	4,844,000
Total Current Assets	113,227,000	108,708,000
Investments—Notes A and D	9,769,000	28,865,000
Property and Equipment—Note E	62,689,000	60,962,000
Other Assets		
Notes and accounts receivable—Note B	10,519,000	12,859,000
Operating authorities and franchises—Note E	5,182,000	5,651,000
Sundry	3,947,000	4,814,000
Excess of cost of investments over underlying net assets of consolidated subsidiaries acquired—Note A	12,132,000	13,604,000
	$217,465,000	$235,463,000

NATIONAL INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31, 1968 Note A	June 30, 1969 (Unaudited) Note A
Current Liabilities		
Notes payable—Note F	$ 17,557,000	$ 16,649,000
Current maturities of long-term debt and convertible subordinated debt—Note G	10,809,000	21,406,000
Accounts payable	26,701,000	31,188,000
Accrued expenses	8,970,000	9,573,000
Income taxes—Note I	5,805,000	3,039,000
Total Current Liabilities	69,842,000	81,855,000
Long-Term Debt, less current maturities—Note G	41,261,000	45,155,000
Deferred Liabilities and Credits		
Income taxes	4,421,000	4,899,000
Deferred income	4,424,000	4,198,000
	8,845,000	9,097,000
Convertible Subordinated Debt, less current maturities—Note G	31,273,000	31,235,000
Stockholders' Equity—Notes G and H		
Preferred Stock, cumulative convertible, par value $1 a share:		
Authorized 5,000,000 shares		
Series A, $.60 (Involuntary liquidation value 1968—$3,200,000; 1969—$2,760,000)		
Issued and outstanding: 1968—160,000 shares; 1969—138,000 shares	160,000	138,000
Series B, $1.25 (Involuntary liquidation value $4,732,000)		
Issued and outstanding—182,000 shares	182,000	182,000
Common Stock par value $1 a share:		
Authorized 12,000,000 shares		
Issued and outstanding: 1968—6,653,000 shares; 1969—6,702,000 shares	6,653,000	6,702,000
Additional paid-in capital	35,269,000	35,860,000
Retained earnings	24,355,000	25,884,000
	66,619,000	68,766,000
Less cost of shares (1968—61,000 shares; 1969—62,000 shares) of Common Stock in treasury	375,000	645,000
	66,244,000	68,121,000
Commitments and Contingent Liabilities—Note I		
Subsequent Events—Note J		
	$217,465,000	$235,463,000

See notes to consolidated financial statements.

NATIONAL INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES

STATEMENTS OF CONSOLIDATED STOCKHOLDERS' EQUITY

For the three years ended December 31, 1968 (Audited), and six months ended June 30, 1969 (Unaudited)

	Preferred Stock Par Value $1.00		Common Stock Par Value $1.00	Treasury Stock	Additional Paid-In Capital	Retained Earnings
	Series A	Series B				
Balances at January 1, 1966, as previously reported	$240,000	$182,000	$5,862,000	$(69,000)	$26,495,000	$ 8,878,000
Acquisition of businesses acquired in pooling or part-pooling transactions—Note A	—	—	715,000	69,000	2,932,000	5,776,000
Balances at January 1, 1966, as restated—Note A	240,000	182,000	6,577,000	—	29,427,000	14,654,000
Net income for 1966	—	—	—	—	—	4,754,000
Cost of 140,000 shares of Common Stock purchased for treasury	—	—	—	(842,000)	—	—
Adjustment to Common Stock and Treasury Stock for Treasury Stock acquired subsequent to January 1, 1966 and issued in 1967 and 1968 in pooling of interests transactions	—	—	(452,000)	452,000	—	—
Issuance of 100,000 shares of Common Stock for assets	—	—	100,000	—	200,000	—
Dividend of 41,000 shares of common stock of Retail Centers of the Americas, Inc. at average carrying amount	—	—	—	—	—	(160,000)
Cash dividends paid by pooled businesses prior to acquisition	—	—	—	—	—	(2,641,000)
Adjustments for businesses acquired in pooling or part-pooling transactions	—	—	—	—	281,000	(1,634,000)
Balances at December 31, 1966	240,000	182,000	6,225,000	(190,000)	29,908,000	14,973,000
Net income for 1967	—	—	—	—	—	7,540,000
Sale of 22,000 shares of Common Stock	—	—	1,000	105,000	181,000	—
Cost of 61,000 shares of Common Stock purchased for treasury	—	—	—	(307,000)	—	—
Issuance of 5,000 shares of Common Stock for assets	—	—	—	45,000	99,000	—
Dividend of 39,000 shares of common stock of Retail Centers of the Americas, Inc. at average carrying amount	—	—	—	—	—	(191,000)
Cash dividends paid by pooled businesses prior to acquisition	—	—	—	—	—	(1,306,000)
Adjustments for businesses acquired in pooling or part-pooling transactions	—	—	—	—	409,000	(118,000)
Balances at December 31, 1967	240,000	182,000	6,226,000	(347,000)	30,597,000	20,298,000

NATIONAL INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES

STATEMENTS OF CONSOLIDATED STOCKHOLDERS' EQUITY—(Continued)

	Preferred Stock Par Value $1.00		Common Stock Par Value $1.00	Treasury Stock	Additional Paid-In Capital	Retained Earnings
	Series A	Series B				
Net income for 1968	—	—	—	—	—	7,169,000
Issuance of Common Stock in connection with conversion of Series A Preferred Stock and debentures	(80,000)	—	264,000	—	1,139,000	—
Sale of 40,000 shares (27,000 under stock option plan and 13,000 under warrants) of Common Stock	—	—	27,000	58,000	270,000	—
Cost of 20,000 shares of Common Stock purchased for treasury	—	—	—	(191,000)	—	—
Issuance of 7,000 shares of Common Stock for assets	—	—	6,000	5,000	169,000	—
Cash dividends paid by pooled businesses prior to acquisition	—	—	—	—	—	(341,000)
Adjustments for businesses acquired in pooling or part-pooling transactions	—	—	—	—	308,000	(282,000)
Dividends						
Cash—Preferred	—	—	—	—	—	(164,000)
Common Stock—2%—Common—at fair market value	—	—	130,000	—	2,786,000	(2,924,000)
Balances at December 31, 1968	160,000	182,000	6,653,000	(375,000)	35,269,000	24,255,000
Net income for six months ended June 30, 1969	—	—	—	—	—	1,884,000
Issuance of Common Stock in connection with conversion of Series A Preferred Stock and debentures	(22,000)	—	31,000	—	(5,000)	—
Issuance of Common Stock in connection with exercise of employee stock options	—	—	18,000	—	187,000	—
Cost of 36,000 shares of Common Stock purchased for treasury	—	—	—	(652,000)	—	—
Sale of 27,000 shares of Common Stock pursuant to employment agreement	—	—	—	289,000	257,000	—
Issuance of warrants to acquire up to 125,000 shares of National's Common Stock in connection with the purchase of shares of TSC stock	—	—	—	—	140,000	—
Cash dividends—Preferred	—	—	—	—	—	(155,000)
Issuance of 9,000 shares of Common Stock for assets, and sundry	—	—	—	93,000	12,000	—
Balances at June 30, 1969 (Unaudited)	$138,000	$182,000	$6,702,000	$(645,000)	$35,860,000	$25,884,000

See notes to consolidated financial statements.

NATIONAL INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Three Years Ended December 31, 1968 (Audited) and Six Months Ended June 30, 1969 (Unaudited)

NOTE A—PRINCIPLES OF CONSOLIDATION AND ACQUISITION AND DISPOSITION OF BUSINESSES

The consolidated financial statements consolidate the accounts of National and all of its majority-owned subsidiaries except those of LaSalle National Insurance Company, which are included on an equity basis, after eliminating intercompany accounts and transactions.

During the four years and six months ended June 30, 1969, National acquired nine businesses which were accounted for as poolings of interests, five businesses accounted for as a part-purchase and part-poolings of interests, and sixteen businesses accounted for as purchase transactions. The operations of the pooled businesses and part-pooled, part-purchased businesses have been included in the statement of consolidated income for the four years and six months ended June 30, 1969, with the purchased portion of the net income of such companies deducted as indicated in the statement of consolidated income. The operations of the purchased businesses are included in the statement of consolidated income since dates of acquisition.

In June, 1969, National sold its investment in LaSalle (90% of the outstanding common stock at the date of sale) and its interest in an underwriting management agreement with LaSalle for $3,500,000, payable $500,000 in June, 1969 and $500,000 annually on June 1 (beginning 1970).

The excess of cost of investments at dates of acquisition over underlying net assets of consolidated subsidiaries acquired aggregating $12,132,000 and $13,604,000 at December 31, 1968, and June 30, 1969, respectively, is not being amortized since it is believed to have continuing value.

National's investment in consolidated subsidiaries exceeds its equity in the net assets of such subsidiaries. The accounting for this excess in the consolidated financial statements is as follows:

	December 31, 1968	June 30, 1969 (Unaudited)
Charged to:		
Property and equipment	$ 6,555,000	$ 6,038,000
Excess of cost of investments over underlying net assets of consolidated subsidiaries acquired	11,247,000	12,719,000
Operating authorities and franchises	2,792,000	2,831,000
Investments—LaSalle	621,000	—
Deferred income	2,526,000	2,401,000
Sundry	92,000	92,000
	23,833,000	24,081,000
Credited to:		
Notes and accounts receivable:		
Current	70,000	70,000
Noncurrent	2,343,000	2,132,000
Deferred income taxes	1,431,000	1,416,000
	3,844,000	3,618,000
	$19,989,000	$20,463,000

NOTE B—NOTES AND ACCOUNTS RECEIVABLE

	December 31, 1968	June 30, 1969 (Unaudited)
Trade accounts receivable	$40,885,000	$41,252,000
Other receivables	1,899,000	2,538,000
	42,784,000	43,790,000
Less allowance for doubtful accounts	1,524,000	1,597,000
	41,260,000	42,193,000
Notes receivable	12,603,000	17,129,000
	$53,863,000	$59,322,000
Current portion	$43,344,000	$46,463,000
Noncurrent portion	10,519,000	12,859,000
	$53,863,000	$59,322,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS–(Continued)

At December 31, 1968 and June 30, 1969 a minor part of the total of notes and accounts receivable were pledged on certain indebtedness.

NOTE C–INVENTORIES

Inventories used in computing cost of goods sold for the four years and six months ending June 30, 1969 were as follows:

January 1, 1965	$18,962,000
December 31, 1965	$23,182,000
December 31, 1966	$28,274,000
December 31, 1967	$28,953,000
December 31, 1968	$37,856,000
June 30, 1969	$45,310,000

Inventories were valued at the lower of cost (principally first-in, first-out method) or market.

NOTE D–INVESTMENTS

	December 31, 1968	June 30, 1969 (Unaudited)
LaSalle National Insurance Company:		
Common stock—partially pledged	$3,725,000	$ —
7% Subordinated Convertible Surplus Debenture Notes—face amount—at cost—approximate market—pledged	1,000,000	1,000,000
General Nursing Homes Corporation (formerly Computer Research, Inc.)—at cost	937,000	937,000
TSC Industries, Inc.—at cost of $23,285,000 less $1,075,000 assigned to prepaid interest—plus $568,000 assigned to deferred income tax—partially pledged	—	22,778,000
Real estate held for investment—at cost	4,107,000	4,089,000
Other—at cost	—	61,000
	$9,769,000	$28,865,000

The 7% Subordinated Convertible Surplus Debenture Notes of LaSalle are convertible into common shares of LaSalle on the basis of one share for each $3 of principal amount of debentures and accrued interest thereon. The buyer of the LaSalle common stock has the obligation to purchase the debenture notes if National serves notices of intent to sell these notes during the period from June 1, 1973 to May 31, 1974.

In February, 1969, National purchased 439,675 shares of the outstanding $.70 Cumulative Convertible Preferred Stock and 434,682 shares of the outstanding common stock of TSC Industries, Inc. At July 31, 1969, National owned 47% of the outstanding preferred stock and 24% of the outstanding common stock. The purchase price was satisfied by paying cash and issuing 5% installment promissory notes aggregating $17,200,000, which are payable in six installments beginning February 7, 1970 (the first five installments to be 10% of the purchase price and the balance to be payable at the conclusion of the sixth year) and issuing National warrants for 125,000 shares of National Common Stock entitling the holder to purchase National Common Stock during the period commencing on February 8, 1974, and ending on February 7, 1975, at $24.00 per share. The approximate market value of the TSC preferred and common stock owned by National at June 30, 1969 aggregated $12,200,000. The excess cost of National's investment in TSC Industries, Inc. over its equity in the net assets of TSC at June 30, 1969 amounted to $15,200,000 assuming that National's investment in the TSC preferred stock was converted into shares of TSC common stock.

The aggregate quoted market value of General Nursing Homes Corporation is significantly in excess of cost; however, there is no assurance the quoted market value can be realized upon disposition of this investment.

NOTE E–PROPERTY AND EQUIPMENT–PARTIALLY PLEDGED–AND OPERATING AUTHORITIES AND FRANCHISES

Property and equipment are stated at cost less allowances for depreciation, depletion and amortization as follows:

	December 31, 1968	June 30, 1969 (Unaudited)
Land	$ 3,861,000	$ 4,857,000
Buildings and improvements	19,460,000	19,973,000
Transportation and revenue equipment	10,833,000	10,533,000
Equipment, furniture, and fixtures	34,356,000	36,310,000
Containers	1,577,000	1,637,000
Oil and gas properties	13,835,000	13,835,000
Leasehold improvements	3,942,000	4,233,000
	$87,863,000	$91,358,000
Less allowances for depreciation, depletion, and amortization	25,174,000	30,396,000
	$62,689,000	$60,962,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS–(Continued)

Provision for depreciation of property and equipment is based on annual rates, applied generally by the straight-line method, which are sufficient to amortize the cost of depreciable assets within the period of their estimated useful lives. Leasehold improvements are amortized over the life of the leases. It is not practicable to state the range of the various depreciation rates since there are numerous classes and rates.

Maintenance and repair expenditures are charged to expense. Betterments and renewals have been charged to the appropriate property accounts. Upon sale or other disposal of properties, the cost and applicable reserves are removed from the accounts in the year of disposal and the gain or loss is credited or charged to income at the same time.

National believes that the operating authorities and cab franchises have a continuing value and therefore is not amortizing the cost thereof. The policy of National is to amortize the cost of a petroleum products distribution franchise (unamortized cost at December 31, 1968 and June 30, 1969 was $215,000 and $191,000 respectively) over its term (160 months) on the straight-line method.

NOTE F–NOTES PAYABLE

The current notes payable (principally to banks) in the amount of $17,557,000 and $16,649,000 at December 31, 1968 and June 30, 1969, respectively, are partially collateralized by the capital stock of certain of the consolidated subsidiaries and by the pledge of trade accounts receivable and inventories.

NOTE G–LONG-TERM DEBT AND CONVERTIBLE SUBORDINATED DEBT

	December 31, 1968	June 30, 1969 (Unaudited)
Long-Term Debt:		
Secured:		
Bank notes—interest rates ranging from 5½% minimum rate to ½% above the prime rate (8½% at June 30) collateralized by common stock of a consolidated subsidiary, National's interest in gross income from producing oil and gas properties, other investments and certain revenue equipment	$ 4,266,000	$ 5,590,000
Mortgage notes secured by real estate—interest ranging from 5% to 7%	4,825,000	6,087,000
Installment equipment notes—interest ranging from 5% to 7¾%	3,755,000	4,023,000
Unsecured:		
Notes to banks and others—interest principally at a rate ½% above the prime rate	20,133,000	14,410,000
Notes to insurance companies—interest ranging from 5½% to 6½%	13,150,000	12,900,000
6% senior notes	1,350,000	1,200,000
5% subordinated debentures—due January 1, 1976	506,000	476,000
5% installment promissory notes to individuals (relative to purchase of common and preferred stock of TSC Industries, Inc.—Note D)	—	17,200,000
Other notes payable—interest ranging from 5% to 6½%	3,914,000	4,553,000
	51,899,000	66,439,000
Less amounts classified as current maturities of long-term debt and convertible subordinated debt	10,638,000	21,284,000
	$41,261,000	$45,155,000
Convertible Subordinated Debt:		
5¾%—due October 1, 1988	$25,000,000	$24,997,000
5½%—due January 1, 1980	5,994,000	5,960,000
6%—due June 15, 1977	450,000	400,000
	$31,444,000	$31,357,000
Less amounts classified as current maturities of long-term debt and convertible subordinated debt	171,000	122,000
	$31,273,000	$31,235,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The maturities and installment payments with respect to long-term debt and convertible subordinated debt during the five years subsequent to December 31, 1968 and June 30, 1969 (unaudited) are set forth below:

	Year Ended	
	December 31, 1968	June 30, 1969 (Unaudited)
1969	$10,809,000	$ —
1970	18,245,000	21,406,000
1971	4,008,000	7,986,000
1972	2,656,000	6,734,000
1973	2,388,000	6,067,000
1974	—	5,031,000
	$38,106,000	$47,224,000

See page 12—Capitalization—for amounts and due dates of long-term debt by obligation.

Unsecured notes to banks at December 31, 1968 and June 30, 1969, include a loan of $15,000,000 and $10,000,000 respectively under terms which restrict future borrowings without the consent of the bank and require that National's consolidated net worth not be reduced below $24,000,000. In May, 1969, the loan agreement was amended to provide that National's consolidated net worth not be reduced below $30,000,000.

Notes to insurance companies and 6% senior notes represent indebtedness of subsidiaries of National and, under the terms of the various loan agreements, there are certain restrictions on the subsidiaries as to the payment of dividends, additional borrowings, and/or purchase of stock, etc., and other minimum requirements as to working capital and/or retained earnings.

The 5% interest rate on the installment promissory notes to individuals (relative to the purchase of TBC stock) is less than the prime rate charged by banks at the date of the transaction. The Company has assigned a portion of the purchase price to prepaid interest, which increases the stated interest rate of 5% to a rate approximating the bank prime interest rate at the date of the transaction.

The 5¾% convertible subordinated debentures (issued October, 1968) due October 1, 1988, are convertible into shares of Common Stock of National on the basis of one share for each $33.53 principal amount of debentures. At December 31, 1968 and June 30, 1969, there were approximately 1,062,000 shares of Common Stock of National reserved for conversion. The conversion price is subject to adjustment to protect against dilution. The debentures are redeemable at any time after October 1, 1969, at prices declining from 105¾%. Sinking fund requirements of $2,500,000 are required each year from October 1, 1979 through October 1, 1987; however, National receives credit for debentures redeemed, surrendered for conversion or otherwise acquired.

The 5½% convertible subordinated debentures (originally issued by Crescent Corporation) due January 1, 1980, are currently convertible into shares of Common Stock of National on the basis of one share for each $32.08⅓ principal amount of debentures. At December 31, 1968 and June 30, 1969, there were approximately 188,000 and 186,000, respectively, shares of Common Stock of National reserved for conversion. The conversion price is subject to adjustment to protect against dilution. The debentures are redeemable at any time, and redemption of 2% of the principal amount of debentures is required annually through the operation of a sinking fund.

The 6% convertible subordinated notes (originally issued by Royal School Laboratories, Inc.) due June 15, 1977, are currently convertible into shares of Common Stock of National on the basis of one share for each $26.47 principal amount of the notes until December 15, 1969, and one share for each $27.45 principal amount thereafter. The conversion price is subject to adjustment to protect against dilution. At December 31, 1968 and June 30, 1969, there were approximately 17,000 and 15,000, respectively, shares of Common Stock of National reserved for conversion. The debentures mature in $50,000 annual installments through 1977.

NOTE H—STOCKHOLDERS' EQUITY, STOCK OPTIONS, AND WARRANTS

On June 20, 1968, the stockholders approved the authorization of 5,000,000 shares of a class of Preferred Stock, par value $1 a share, issuable in series, and the increase in the authorized Common Stock from 5,000,000 shares to 12,000,000 shares. The $.60 Series A Cumulative Convertible Preferred Stock is convertible into 1.4 shares of Common Stock of National, is redeemable beginning in 1973 at $31.50 a share, and has an involuntary liquidation value of $20.00 a share. The $1.25 Series B Cumulative Convertible Preferred Stock is convertible into 0.75 shares of Common Stock of National, is redeemable at any time at $26.00 per share, and has an involuntary liquidation value of $26.00 a share. In the opinion of counsel, the excess of the liquidation value over par value imposes no restrictions on the payment of dividends.

At December 31, 1968 and June 30, 1969, approximately $14,000,000 of National's retained earnings were subject to cash dividend restrictions in accordance with National's most restrictive indenture agreement, covering the 5¾% convertible subordinated debentures due 1988.

Stock options have been granted to certain officers and other key employees to purchase Common Stock of National at the market price at date of grant. Options are nonassignable and expire five years from date of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

grant. At June 30, 1969, 51,000 options were exercisable; remaining options may be exercised as follows: six months ending December 31, 1969—15,000 shares; calendar 1970—115,000 shares; 1971—108,000 shares; 1972—38,000 shares; 1973—3,000 shares. A summary of option transactions during the three years ended December 31, 1968 (audited) and six months ended June 30, 1969 (unaudited) follows:

		Option Price		Market Price	
	Shares(A)	Range Per Share(A)	Aggregate	Range Per Share(A)	Aggregate
Granted:					
Year ended December 31,					
1966	160,000	$2.94 to $5.39	$ 831,000	$2.94 to $5.39	$ 831,000
1967	110,000	2.94 to 15.44	677,000	2.94 to 15.44	677,000
1968	112,000	17.03 to 20.59	2,258,000	17.03 to 20.59	2,258,000
Six months ended June 30, 1969	8,000	21.25	170,000	21.25	170,000
Assumed in connection with mergers:					
Year ended December 31,					
1966	None				
1967	None				
1968	87,000	7.47 to 26.15	1,229,000	20.83 to 25.86	2,250,000
Six months ended June 30, 1969	None				
Became exercisable:					
Year ended December 31,					
1966	4,000	2.94 to 5.39	21,000	2.94 to 5.39	21,000
1967	8,000	2.94 to 15.44	40,000	4.29 to 15.44	37,000
1968	57,000	2.94 to 19.10	702,000	20.59 to 25.86	1,437,000
Six months ended June 30, 1969	29,000	2.94 to 7.47	170,000	11.50 to 22.25	617,000
Exercised:					
Year ended December 31,					
1966	None				
1967	300	4.90	1,000	12.62	4,000
1968	27,000	2.94 to 19.59	288,000	18.38 to 25.12	629,000
Six months ended June 30, 1969	18,000	4.90 to 15.67	205,000	12.00 to 23.63	379,000
Terminated:					
Year ended December 31,					
1966	90,000	7.11 to 9.07	656,000		
1967	53,000	5.39	287,000		
1968	23,000	2.94 to 26.15	404,000		
Six months ended June 30, 1969	400	7.47 to 17.40	4,000		
Outstanding at:					
December 31, 1968	340,000	2.94 to 26.15	3,877,000	2.94 to 25.86	4,715,000
June 30, 1969	330,000	2.94 to 26.15	3,838,000	2.94 to 25.86	4,530,000
Exercisable at:					
December 31, 1968	40,000	2.94 to 19.10	472,000	2.95 to 26.38	1,029,000
June 30, 1969	51,000	2.94 to 19.10	451,000	21.25 to 26.38	1,166,000
Reserved for future options at:					
December 31, 1968(B)	121,000				
June 30, 1969(B)	113,000				

(A) Adjusted for 2% Common Stock dividend declared by the Board of Directors on December 16, 1968.

(B) Adjusted for shareholders' approval, on May 15, 1969, of a 100,000 share increase in the shares of Common Stock reserved under the plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

There have been no charges or credits to income in connection with such options, and none are anticipated.

See Note J regarding cancellation and reissuance of certain options subsequent to June 30, 1969.

National has warrants outstanding at December 31, 1968 and June 30, 1969, to purchase shares of Common Stock of National as follows:

1. Warrants to purchase 38,250 shares at $4.90 per share may be exercised as follows: July 1, 1969—12,750 shares; July 1, 1970—12,750 shares; July 1, 1971—12,750 shares. Any portion not exercised is noncumulative and all rights to exercise expire one year after the date they become exercisable.

2. Warrants to purchase 486,576 shares at $21.40 per share may be exercised at any time through October 31, 1978.

3. At June 30, 1969, National had additional warrants outstanding (issued in connection with the acquisition of its investment in TSC Industries, Inc.—see Note D) for 125,000 shares of Common Stock at $34.00 per share. The warants may be exercised during the period commencing on February 8, 1974, and ending on February 7, 1975.

The warrants contain an anti-dilution clause and have been adjusted where applicable for the 2% Common Stock dividend.

Included in notes and accounts receivable is a note ($273,000) due from an officer of the Company in connection with the officer's purchase of 13,000 shares of National's Common Stock.

See "Capitalization" for a summary of shares reserved for conversions, options, warrants, etc. at August 31, 1969.

See Note 2 of notes to statements of consolidated income.

NOTE I—COMMITMENTS AND CONTINGENT LIABILITIES

National and several of its subsidiaries have noncontributory pension plans which can be terminated at any time at the companies' option. Total pension expense for the year ended December 31, 1968 was approximately $250,000 and for the six months ended June 30, 1969, was approximately $216,000, which includes, as to certain of the plans, amortization of prior service cost over 30 years. The policy of the subsidiaries is to fund pension cost accrued.

The aggregate annual obligation on leases having terms of more than three years from December 31, 1968 and June 30, 1969, was $2,962,000. Many of the leases also require the lessee to pay property taxes, insurance, and ordinary repairs and maintenance. The leases have varying terms up to twenty-seven years.

National has guaranteed or is contingently liable on certain indebtedness, approximately $1,000,000, of individuals and others unrelated to National. This amount is partially collateralized by certain assets of others. National does not believe that it will incur a liability as a result of this contingency.

National and its eligible subsidiaries have filed a consolidated federal income tax return for 1968 and intend to file a consolidated federal income tax return for 1969. Prior years income tax returns of National and some of its subsidiaries are currently being examined by the Internal Revenue Service. Deficiencies have been assessed in certain cases; however, in the opinion of management no significant additional liabilities will be incurred.

National is one of the defendants in certain pending lawsuits. In the opinion of legal counsel and management the ultimate liability of National in these matters will not be significant.

NOTE J—SUBSEQUENT EVENTS

From June 30, 1969 through September 30, 1969, National has purchased 27,500 shares of its Common Stock on the open market for an aggregate price of $280,000.

On October 18, 1969, the Federal Drug Administration ordered the use of cyclamates in diet beverages discontinued. Management's estimate of the approximate net loss, if any, is $250,000 as a result of the effect of such order. No provision has been made in the financial statements for this estimated loss.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In August, 1969, National cancelled options for 106,000 shares of Common Stock at option prices ranging from $15.75 to $21.25 (aggregating $2,121,000), and in October, 1969 reissued them at the current market price of $10.00 per share. This transaction has not been considered in the computations of earnings per share elsewhere herein because the resulting dilution is not significant.

See Notes to Statements of Consolidated Income for information concerning the disposition of Southern Tank Lines Inc. and its subsidiary.

NOTE K—SUPPLEMENTARY PROFIT AND LOSS INFORMATION

Charged Directly to Income	Year Ended December 31, 1966	1967	1968	Six Months Ended June 30, 1969 (Unaudited)
Maintenance and repairs:				
Cost of goods sold and operating expenses	$2,617,000	$2,546,000	$3,970,000	$2,355,000
Other profit and loss accounts	891,000	997,000	503,000	235,000
	$3,508,000	$3,543,000	$4,473,000	$2,590,000
Taxes, other than income:				
Cost of goods sold and operating expenses	$2,060,000	$2,484,000	$3,488,000	$2,098,000
Other profit and loss accounts	1,539,000	1,601,000	1,493,000	661,000
	$3,599,000	$4,085,000	$4,981,000	$2,759,000
Rents and royalties:				
Cost of goods sold and operating expenses	$2,420,000	$2,811,000	$3,672,000	$1,946,000
Other profit and loss accounts	774,000	1,195,000	1,489,000	764,000
	$3,194,000	$4,006,000	$5,161,000	$2,710,000

Depreciation and amortization are included as separate items in the statement of consolidated income.

These amounts do not include amounts charged to income (loss) from discontinued operations.

OPINION OF INDEPENDENT ACCOUNTANTS

We have examined the consolidated balance sheet of TSC Industries, Inc. and its consolidated subsidiaries as of October 31, 1968 and the related consolidated statements of additional paid-in capital and retained earnings for the three years ended October 31, 1968. We have also examined the related consolidated statement of income for the five years ended October 31, 1968. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements referred to above present fairly the consolidated financial position of TSC Industries, Inc. and its consolidated subsidiaries at October 31, 1968, and the consolidated results of their operations for the five years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

CHECKERS, SIMON & ROSNER

Chicago, Illinois
December 16, 1968

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEET—(Note 1)

ASSETS

	October 31, 1968 (Audited)	July 31, 1969 (Unaudited)
CURRENT ASSETS		
Cash	$ 1,745,727	$ 2,718,816
Accounts receivable, less allowance (1968—$91,984; 1969—$126,637)	3,770,161	4,379,779
Inventories—at lower of cost (substantially first-in, first-out and retail methods) or market (Note 3)	41,328,284	43,996,912
Miscellaneous receivables	1,645,758	634,181
Prepaid expenses and other current assets	813,810	934,744
TOTAL CURRENT ASSETS	49,303,740	52,664,432
OTHER ASSETS		
Investment in and advances to unconsolidated subsidiary (Note 1)	859,097	954,408
Miscellaneous accounts	766,109	765,756
	1,625,206	1,720,164
PROPERTY, PLANT AND EQUIPMENT—on the basis of cost (Notes 4, 5, 6 and 10)		
Land	1,622,396	1,991,290
Buildings and building improvements	6,085,795	5,637,308
Machinery and equipment	6,948,626	7,444,696
Leasehold improvements	3,978,106	5,225,714
	18,634,923	20,299,008
Allowances for depreciation and amortization	4,667,481	5,760,192
	13,967,442	14,538,816
	$64,896,388	$68,923,412

See notes to consolidated financial statements.

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEET—(Note 1)

LIABILITIES AND STOCKHOLDERS' EQUITY

	October 31, 1968 (Audited)	July 31, 1969 (Unaudited)
CURRENT LIABILITIES		
Notes payable—banks and others	$ 4,976,252	$ 7,464,002
Accounts payable	15,015,626	13,322,911
Accrued expenses	3,376,824	3,493,511
Federal income taxes	1,171,046	991,968
Current maturities of long-term debt	369,171	1,372,106
TOTAL CURRENT LIABILITIES	24,908,919	26,644,498
LONG-TERM DEBT—less portion classified as current liability (Note 5)	17,436,617	16,650,718
DEFERRED CREDITS (Note 6)	468,549	446,224
STOCKHOLDERS' EQUITY (Notes 5, 7, 8, 9 and 10)		
Preferred Stock, par value $1 per share—authorized 3,000,000 shares, issuable in series:		
Series 1 $.70 Cumulative Convertible Stock (Preferred as to Dividends):		
Authorized 1,375,101 shares; issued and outstanding (1968—1,297,001 shares; 1969—912,613 shares)	1,297,001	912,613
Common Stock, par value $1 per share:		
Authorized 5,000,000 shares; issued and outstanding (1968—1,407,939 shares; 1969—1,851,778 shares)	1,407,939	1,851,778
Additional paid in capital	6,284,789	9,225,107
Retained earnings	13,092,574	13,192,474
	22,082,303	25,181,972
COMMITMENTS AND CONTINGENCIES (Note 10)		
	$64,896,388	$68,923,412

See notes to consolidated financial statements.

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENT OF ADDITIONAL PAID-IN CAPITAL—(Note 1)

	Year Ended October 31, 1966	1967	1968	(Unaudited) Nine Months Ended July 31, 1969
Balance at beginning of period	$6,038,233	$ 6,038,233	$ 6,088,083	$ 6,284,789
Add (deduct):				
Proceeds in excess of par value of stock options exercised		49,850	100,088	2,350
Conversion of $300,000 Subordinated Convertible Debentures into Preferred Shares			240,000	
Conversion of Preferred Shares into Common Shares			22,358	97,949
Proceeds in excess of par value of Common Stock sold				2,858,348
Shares repurchased and canceled			(5,762)	
Expenses incurred in connection with merger			(159,978)	(11,329)
Additional shares of $.70 Cumulative Convertible Stock issued under agreement to acquire SAS, Inc.—(Note 10)				(7,000)
Balance at end of period	$6,038,233	$ 6,088,083	$ 6,284,789	$ 9,225,107

CONSOLIDATED STATEMENT OF RETAINED EARNINGS—(Note 1)

Balance at beginning of period	$5,205,043*	$ 7,595,378	$10,526,255	$13,092,574
Add—net income for the period	3,252,600	3,944,980	3,963,902	1,784,466
	8,457,643	11,540,358	14,490,157	14,877,040
Deduct:				
Cash dividends declared:				
Preferred Shares	—	—	641,779	668,254
Common Shares	621,022	663,824	755,804	1,016,312
Excess of cost over stated value of canceled treasury shares of pooled subsidiary		350,279		
Duplication of net income resulting from combining fiscal periods**	241,243			
TOTAL	862,265	1,014,103	1,397,583	1,684,566
Balance at end of period	$7,595,378	$10,526,255	$13,092,574	$13,192,474

* Includes retained earnings of Community Discount Centers, Inc. as of November 1, 1965.

** Represents duplication of net income for the three months ended January 31, 1967 (See Note A to Consolidated Statement of Income) less net income of $455,353 for the three months ended January 31, 1968.

See notes to consolidated financial statements.

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS
October 31, 1968 and July 31, 1969
(Information relating to July 31, 1969 is unaudited)

NOTE 1—PRINCIPLES OF CONSOLIDATION:

The accompanying financial statements present the consolidated financial position and results of operations of TSC Industries, Inc. and all of its subsidiaries other than Mages Sports Arenas, Inc. which operates two bowling establishments in the Chicago area. All intercompany accounts, transactions and earnings of the consolidated subsidiaries have been eliminated in the consolidated statements.

The investment in the unconsolidated subsidiary is carried in the accompanying balance sheet at cost less the applicable share of accumulated losses.

The merger of Tractor Supply Co. and Community Discount Centers, Inc. into TSC Industries, Inc. became effective February 19, 1968. On February 28, 1967 Tractor Supply Co. acquired Big Bear, Inc. and on April 29, 1968, TSC Industries, Inc. acquired SAS, Inc. These transactions have been treated as poolings of interests and accordingly the accompanying financial statements have been retroactively adjusted to reflect the combined consolidated financial position and results of operations of all of the entities.

The investments in the consolidated subsidiaries are carried on the books of the parent company at its cost for subsidiaries purchased or for subsidiaries it caused to be incorporated and at book value at the effective date of acquisition for those subsidiaries accounted for as a pooling of interests. The parent's equity in the net assets of the subsidiaries consolidated exceeds the amount at which the parent carries such investment by $7,159,422 at October 31, 1968 and $8,493,053 at July 31, 1969. This amount is included in the consolidated balance sheet as follows:

	October 31, 1968		July 31, 1969	
	Debit	Credit	Debit	Credit
Retained earnings	$ —	$6,862,679	$ —	$8,212,509
Deferred credit	—	468,543	—	446,224
Other assets	128,885	—	122,759	—
Additional paid-in capital	57,375	—	57,375	—
Current items	5,482	19,936	5,482	19,936

NOTE 2—PURCHASE OF STORES:

Pursuant to an agreement of October 27, 1967 a predecessor of TSC Industries, Inc. contracted to acquire substantially all of the assets of 19 previously existing department stores plus one department store then under construction. The assets consisted primarily of merchandise inventory, miscellaneous cash items, fixed assets, contract rights and the rights of the sellers, as tenants, in the leases relating to the stores.

The results of operations for the year ended October 31, 1968 are shown in Note B to the Consolidated Statement of Income and include:

(i) Fourteen stores for the entire period.

(ii) Five stores from May 9, 1968, the date on which those stores commenced operations under the company's ownership.

(iii) One store from August 1, 1968, the date on which the newly constructed store commenced operations.

NOTE 3—INVENTORIES:

Inventories, consisting primarily of finished goods, are priced substantially at the lower of cost or market. Costs are determined, for the most part, on the first-in, first-out and retail methods.

Inventories used in the financial statements for the three years ended October 31, 1968 and nine months ended July 31, 1969 were as follows:

November 1, 1965	$17,607,615*
October 31, 1966	19,691,685*
October 31, 1967	32,130,144
October 31, 1968	41,223,284
July 31, 1969	43,996,913

* See Note A to Consolidated Statement of Income.

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS—(Continued)

NOTE 4—DEPRECIATION, OBSOLESCENCE AND AMORTIZATION:

The fixed assets are stated at cost. Provision for depreciation has been computed principally by the straight-line method with nominal amounts being computed by the double-declining and sum of the years-digits methods. The ranges of annual depreciation rates are as follows:

Buildings and improvements	2-10%
Machinery and equipment	10-33⅓%
Leasehold improvements	Over life of leases or 10-33⅓%

Expenditures for maintenance and repairs are charged to expenses. Expenditures for renewals and betterments are capitalized. Cost of assets sold or disposed of are eliminated from the accounts and the resulting profit or loss is reflected in the statement of income except as explained in Note 6.

NOTE 5—LONG-TERM DEBT:

The long-term debt consisted of the following:

	At October 31, 1968	At July 31, 1969
Notes payable—bank	$13,500,000	$12,750,000
Mortgages and contracts payable	3,210,416	3,468,123
Notes payable—other—interest at 6½%, payable in two equal installments in June 1970 and 1971	350,000	175,000
Sundry other long-term debt	376,201	257,595
TOTAL	$17,436,617	$16,650,718

On September 18, 1968 TSC Industries, Inc. refinanced a substantial portion of its notes payable—banks, whereby it executed a loan agreement and borrowed $13,500,000. The loan which bears interest at ¾% above the prime rate in effect from time to time, is repayable in seven annual installments; $750,000 on January 15, 1970, $2,000,000 annually for five years commencing January 5, 1971 and a final installment of $2,750,000 on January 5, 1976. The loan agreement contains various restrictions on the activities of TSC Industries, Inc. and its subsidiaries, relating, among other things, to amount and type of other indebtedness, maintenance of working capital equal to or in excess of $18,000,000 and acquisition or disposition of investments and other assets. The agreement also restricts the purchase or redemption of TSC Industries, Inc.'s own capital stock and payment of dividends (other than stock dividends) to stockholders to 50% of consolidated net earnings earned after April 30, 1968, plus $1,700,000; as of October 31, 1968, $1,395,515 of the consolidated retained earnings was free of such restrictions ($1,028,612 at July 31, 1969).

The liability for mortgages and contracts is summarized as follows:

	At October 31, 1968	At July 31, 1969
Number of obligations	39	44
Range of interest rates	5-8%	5-8%
Approximate monthly payments—principal and interest	$44,000	$45,000
Range of final maturity dates	1970-1988	1970-1989

The mortgage notes are secured by certain real estate occupied by the companies.

Approximate maturities on long-term indebtedness for each of the next five years are as follows:

	As of October 31, 1968	As of July 31, 1969
1969	$ 869,171	$ —
1970	1,333,196	1,272,106
1971	2,546,992	2,565,792
1972	2,292,863	2,313,910
1973	2,273,130	2,294,530
1974	—	2,352,952

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS—(Continued)

NOTE 6—SALE AND LEASE BACK:

During the year ended October 31, 1968 the land and buildings in which two department stores are operated were sold and immediately leased back. The "gain" resulting from these transactions (net of applicable federal income taxes) of approximately $361,000 is being amortized over 25 years, the initial terms of the leases.

NOTE 7—MERGER:

In November, 1967, an agreement and plan of merger providing for the merger of Tractor Supply Co. and Community Discount Centers, Inc. into TSC Industries, Inc., a new wholly-owned subsidiary of Tractor Supply Co., was approved by the Boards of Directors of the respective companies. The merger became effective on February 19, 1968, pursuant to the approval of the stockholders of each company.

Accordingly, the outstanding shares of Tractor Supply Co. were exchanged for common stock of TSC Industries, Inc. on a share for share basis and the outstanding shares of Community Discount Centers, Inc. were exchanged for shares of $.70 Cumulative Convertible Stock (preferred as to dividends), Series 1, of TSC Industries, Inc. on a share for share basis.

The financial statements have been retroactively adjusted to reflect the merger as explained in Note 1.

NOTE 8—STOCK OPTIONS:

On September 24, 1968 the Board of Directors, subject to stockholders' approval, adopted a "Qualified Stock Option Plan." A total of 50,000 common shares was reserved for issuance under this plan.

The plan provides that the option price shall be not less than 100% of the market value of the shares at the date of grant, that options may be exercised in whole or in part after one year but not more than five years from the date of grant, and that within these limits the terms of the options may be fixed by the Board of Directors or by a committee of the board appointed for that purpose. Key employees of the company or any subsidiary, including officers and directors so employed, are eligible to receive options under the plan.

Tractor Supply Co., prior to its merger into TSC Industries, Inc., had a qualified stock option plan which became effective as of July 27, 1965. A total of 25,000 Class A shares was reserved for issuance under the plan. The terms of this plan were substantially similar to the one described above. TSC Industries, Inc. common shares will be used in place of the Class A shares of Tractor Supply Co. upon exercise of such options.

Community Discount Centers, Inc., prior to its merger into TSC Industries, Inc., had three common stock option plans. Under one plan, restricted stock options were granted to certain key employees on September 29, 1961 for 17,663 shares of common stock. These options were exercisable from September 29, 1962 to September 29, 1967, but none was ever exercised. Under a second plan, a restricted stock option was granted on January 22, 1963 for 15,000 shares. This option is exercisable from January 22, 1964 to January 22, 1973. The option price is 95% of market value of the shares at the date of grant. The third plan was a qualified stock option plan approved by shareholders in 1963 and authorized the issuance of 30,000 shares through July 31, 1968. The terms of the plan limited the eligible employees to thirty with not more than 3,000 shares to anyone. The options are exercisable six months from the date of grant, but are limited to amounts not in excess of 20% annually on a cumulative basis as to each option. The right to exercise options terminates five years after grant. The option price is not less than 100% of market value of the shares at the date of grant. TSC Industries, Inc. $.70 Cumulative Convertible Stock will be used in place of the common shares of Community Discount Centers, Inc. upon exercise of such options granted under the last two plans described above.

A summary of the options described above follows:

Options for Common Stock:

	Options Outstanding				
	Number of Shares	Option Price		Market Value at Date of Grant	
		Per Share	Total	Per Share	Total
October 31, 1968	22,250	$10.625 to $26.375	$571,094	$10.625 to $26.375	$571,094
July 31, 1969	35,250	10.625 to 26.375	805,219	10.625 to 26.375	805,219

34,250 of the above 35,250 options were surrendered to the Company in September, 1969 by the optionees. Also in September, 1969, 49,700 new options were issued at a price of $10.625, of which 40,000 of such new options are not exercisable until the expiration date of the 34,250 options which were surrendered.

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS—(Continued)

	Options Which Become Exercisable				
	Number of Shares	Option Price		Market Value at Date Options Became Exercisable	
Period Options Became Exercisable		Per Share	Total	Per Share	Total
Year ended October 31:					
1966	6,000	$10.625	$ 63,750	$11.50	$ 69,000
1968	4,000	14.25	57,000	28.625	114,500

	Options Exercised				
	Number of Shares	Option Price		Market Value at Date Options Were Exercised	
Period Options Were Exercised		Per Share	Total	Per Share	Total
Year ended October 31:					
1967	2,000	$10.625	$ 21,250	$14.50	$ 29,000
1968	7,000	10.625 to 14.25	88,875	20.125 to 28.00	172,375

Options for $.70 Cumulative Convertible Stock:

	Options Outstanding				
	Number of Shares	Option Price		Market Value at Date of Grant	
		Per Share	Total	Per Share	Total
October 31, 1968	22,400	$ 6.55 to $14.25	$246,950	$ 6.875 to $14.25	$249,875
July 31, 1969	22,000	6.55 to 14.25	244,200	6.875 to 14.25	247,125

	Options Which Became Exercisable				
	Number of Shares	Option Price		Market Value at Date Options Became Exercisable	
Period Options Became Exercisable		Per Share	Total	Per Share	Total
Year ended October 31:					
1966	5,816	$ 6.55 to $17.178	$ 48,448	$ 4.00 to $ 4.875	$ 27,177
1967	4,700	6.55 to 6.875	31,338	6.125 to 8.875	33,463
1968	7,100	6.55 to 14.25	67,013	18.125 to 22.153	143,162

	Options Exercised				
	Number of Shares	Option Price		Market Value at Date Options Were Exercised	
Period Options Were Exercised		Per Share	Total	Per Share	Total
Year ended October 31:					
1967	4,800	$ 6.875	$ 33,000	$11.625 to $13.75	$ 60,900
1968	3,100	6.875	21,313	19.50 to 27.875	63,800
Nine months ended July 31, 1969	400	6.875	2,750	24.125	9,650

No amounts have been reflected in the income accounts of the companies with respect to stock options. The par value of the optioned stock issued was credited to the capital stock account and the excess of the option price over the par value of the shares issued was credited to additional paid-in capital.

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS—(Continued)

NOTE 9—CAPITAL SHARES:

The changes in the capital share accounts during the year ended October 31, 1968 and nine months ended July 31, 1969 were as follows:

	Year Ended October 31, 1968		Nine Months Ended July 31, 1969	
	Preferred Stock—$1 Par Value	Common Stock—$1 Par Value	Preferred Stock—$1 Par Value	Common Stock—$1 Par Value
Balance at beginning of period	$1,323,518	$1,323,923	$1,297,001	$1,407,939
Additions (deductions):				
Conversion of $300,000 Subordinated Convertible Debentures	60,000	—	—	—
Stock options exercised	3,100	7,000	400	—
Conversion of Preferred Shares into Common Shares	(89,412)	67,054	(391,788)	293,839
Shares repurchased and canceled	(205)	(38)	—	—
Sale of Common Shares	—	—	—	150,000
Shares issued under agreement to acquire SAS, Inc. —Note 10	—	—	7,000	—
	$1,297,001	$1,407,939	$ 912,613	$1,851,778

Each share of Preferred Stock is convertible into ¾ of a share of Common Stock and is redeemable, at the option of the Corporation, on or after July 1, 1973 at a price of $17 per share plus all arrearages in dividends.

NOTE 10—COMMITMENTS AND CONTINGENCIES:

(a) Under an agreement whereby the Company acquired SAS, Inc. the former shareholders of SAS, Inc. could have received up to 47,000 additional shares of $.70 Cumulative Convertible Stock (preferred as to dividends), Series 1, of TSC Industries, Inc. over a five-year period if consolidated earnings of SAS, Inc. and its subsidiaries reach certain levels. 7,000 shares of the above 47,000 shares were issued during the nine months ended July 31, 1969.

This agreement has been amended and the remaining 40,000 shares will be issued in October, 1969.

(b) The companies lease premises at approximately 200 locations at an annual rental aggregating approximately $3,931,000 ($4,128,000 at July 31, 1969). The unexpired terms of the leases vary in length from one to twenty-five years. See "Property."

A lease of the unconsolidated subsidiary is guaranteed by a consolidated subsidiary. This lease expires in 1980 and provides for a minimum annual rental of $40,000.

(c) As security for performance under leases assumed in connection with the purchase of stores described in Note 2 above, the sellers have been granted a conditional reassignment of all of the lessees' interests in such leases and a security interest in the fixed assets acquired thereunder, as well as certain additions and replacements thereto. The conditional reassignment of store leases becomes effective only following an event of default, as defined. The security interest in the fixed assets becomes effective if and when consolidated capital shares and surplus falls below $15,000,000 during the period ended October 27, 1972 or $10,000,000 thereafter. Additional collateral of $1,000,000, or its equivalent, is also required if and when consolidated stockholders' equity falls below $15,000,000 through October 27, 1972.

(d) The Company is presently engaged in negotiations with a bank for the sale of installment accounts receivable as of October 31, 1969. This sale is being made preparatory to electing to report income on such class of accounts on the installment method for federal income tax purposes. If the transaction is consummated as contemplated, short-term bank borrowings would be temporarily reduced by approximately $1,100,000.

NOTE 11—PENSION AND RETIREMENT PLAN:

TSC Industries, Inc. and ten of its subsidiaries have a funded pension plan and a stock bonus plan.

TSC INDUSTRIES, INC. AND ITS CONSOLIDATED SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS—(Continued)

Pension Plan:

Eligible employees who so elect contribute 5% of their earnings which is matched by the companies. These funds are invested in retirement life income annuities. Costs to the companies were:

Year ended October 31:	
1966	$ 58,848
1967	76,665
1968	112,110
Period of nine months ended July 31, 1969	95,379

Stock Bonus Plan:

The stock bonus plan is a noncontributory plan for participants of the pension plan. The companies annually contribute the lesser of 15% of aggregate net profits (as specifically defined) before Federal income taxes or 10% of total participating employees' compensation. The funds have been invested in TSC Industries, Inc. common shares. Costs to the companies were:

Year ended October 31:	
1966	$129,575
1967	157,231
1968	211,155
Period of nine months ended July 31, 1969	178,565

NOTE 12—SUPPLEMENTARY PROFIT AND LOSS INFORMATION:

	Year Ended October 31,			Nine Months Ended July 31,
	1966*	1967*	1968	1969
Maintenance and repairs charged to:				
Cost of sales	$ 33,796	$ 15,761	$ 31,361	$ 27,817
Selling, administrative and general expenses	370,507	530,605	1,071,053	923,160
Depreciation and amortization charged to:				
Cost of sales	69,651	62,976	52,703	41,657
Selling, administrative and general expenses	613,443	700,824	1,342,447	1,135,970
Taxes, other than income taxes:				
Payroll	432,871	506,551	900,678	805,175
Real estate, personal property and other	561,470	531,974	657,641	542,600
Charged to:				
Cost of sales	31,655	30,363	32,113	35,286
Selling, administrative and general expenses	962,686	1,007,662	1,536,201	1,312,489
Rents charged to:				
Cost of sales	16,047	19,337	21,157	29,765
Selling, administrative and general expenses	1,396,695	1,584,999	2,754,223	2,462,971
Bad debts charged to:				
Selling, administrative and general expenses	49,983	84,531	116,705	122,101

*The operating results of Community Discount Centers, Inc. and its subsidiaries for the three months ended January 31, 1967 have been included in both the years ended October 31, 1966 and 1967. See Note A to consolidated statement of income.

EXHIBITS

To

Proxy Statements

of

National Industries, Inc.

and

TSC Industries, Inc.

La Salle Street Press—Chicago/PrinterLink

EXHIBIT A

ARTICLES OF AMENDMENT TO RESTATED ARTICLES OF INCORPORATION OF NATIONAL INDUSTRIES, INC.

KNOW ALL MEN BY THESE PRESENTS:

That the undersigned, National Industries, Inc., a corporation organized and existing under the laws of the Commonwealth of Kentucky, and Stanley R. Yarmuth and Gerald H. Weinstein, who are respectively its President and Secretary, pursuant to a resolution authorizing an amendment which would increase the number of shares of common stock which this corporation may issue from 12,000,000 to 20,000,000 shares, duly and regularly adopted by the affirmative vote of the holders of in excess of two-thirds of the voting power of all shareholders entitled to vote, at a meeting, which was duly and regularly held on the .... day of December, 1969, at ten o'clock A.M. in Louisville, Kentucky, pursuant to due and proper prior written call and notice of the time, place and purpose of said meeting, at which a quorum was present, amends its Restated Articles of Incorporation in the following particular:

The first sentence of Article V is amended so that it shall read as follows:

> The total number of shares of all classes of stock which the Corporation shall have authority to issue is 25,000,000 of which 5,000,000 shares shall be Preferred Stock (hereinafter called the Preferred Stock) of the par value of $1.00 per share, and 20,000,000 shares shall be Common Stock (hereinafter called the Common Stock) of the par value of $1.00 per share.

IN TESTIMONY WHEREOF, witness the signatures of the said corporation and its aforesaid officers this .... day of December, 1969.

NATIONAL INDUSTRIES, INC.

By .....
President

.....
President

.....
Secretary

STATE OF KENTUCKY
COUNTY OF JEFFERSON } ss.:

I, a Notary Public, within and for the State and County aforesaid, do hereby certify that on this day the foregoing instrument of writing was produced before me by Stanley R. Yarmuth and Gerald H. Weinstein personally known to me, who are President and Secretary, respectively, of National Industries, Inc., a Kentucky corporation, a party thereto, and each of them acknowledged and delivered said instrument of writing to be the act and deed of said corporation and to be the act and deed of each of them as President and Secretary aforesaid.

My Notarial Commission will expire .....

IN TESTIMONY WHEREOF, witness my signature and Notarial Seal hereto affixed at Louisville, Kentucky, this .... day of December, 1969.

.....
Notary Public, Kentucky

EXHIBIT B

AGREEMENT

AGREEMENT dated as of the 16th day of October, 1969, between NATIONAL INDUSTRIES, INC., a Kentucky corporation ("National"), and TSC INDUSTRIES, INC., a Delaware corporation ("TSC").

WHEREAS, TSC wishes to sell and National, acting through a wholly-owned subsidiary of National to be organized for such purpose ("Transferee"), wishes to acquire, substantially all of the assets of TSC, in exchange for certain securities of National, and the assumption by Transferee of substantially all of the liabilities of TSC upon the terms and conditions hereinafter set forth; and

WHEREAS, TSC intends as a condition precedent to such sale and purchase to authorize and adopt a plan of complete liquidation of TSC, and following the adoption of such plan and such sale and purchase, to carry out the liquidation of TSC;

Now, THEREFORE, the parties hereto agree as follows:

1. *Transfer of assets*

(a) On the terms and subject to the conditions set forth in this Agreement, TSC agrees to sell, convey, assign, transfer and deliver to Transferee, and National agrees to cause Transferee to purchase and acquire from TSC, all the assets, properties, rights and business of TSC of every kind and description, real, personal and mixed, tangible and intangible, wherever located, in which TSC has any interest, as the same shall exist at the Closing (as defined in Section 9 of this Agreement) or as the same may arise or come into being after the Closing, including, without limitation, all recoveries or rights thereto under any state or federal law, statutory or judicial (hereinafter referred to as the "Purchased Assets"), except the assets, properties and rights described in Section 1(b).

(b) There shall be excluded from the Purchased Assets, the following:

(i) all share transfer and issuance books and records of TSC;

(ii) such amount of cash as TSC and National shall agree to in writing which shall be used to pay TSC's reasonable expenses in carrying out the provisions of this Agreement, including auditors' and attorneys' fees and expenses, the cost of security transfer taxes and excise taxes which may be imposed upon or be payable in respect of the transfer of the Purchased Assets, the expenses of TSC in distributing to its Stockholders the securities of National it receives as part of the purchase price pursuant to Section 2 of this Agreement, and the other expenses of dissolution and liquidation of TSC;

(iii) the rights of TSC under this Agreement, or which may arise or come into being by reason of this Agreement after the Closing; and

(iv) the securities of National delivered pursuant to Section 2 of this Agreement.

(c) Included in the assets to be conveyed hereunder are all rights of TSC to use within or without the continental United States, the names "Tractor Supply Company" and "TSC" or any variation thereof. Conveyance of such assets shall include delivery of assignments transferring the rights of TSC under all of its patents, copyrights, trademarks, service marks and trade names to the full extent that such rights are transferable.

(d) All securities included in the assets to be acquired by Transferee shall be delivered in form for transfer and all Federal, state or local transfer taxes payable on transfer thereof shall be paid by TSC out of the funds referred to in Section 1(b)(ii). Any recording costs on the conveyance or transfer of the real and personal property included in the assets to be acquired by Transferee shall be paid by TSC out of the funds to be retained by TSC.

(e) From the funds retained by TSC, TSC will, as promptly as practicable after the Closing Date, pay all of its obligations referred to in Section 1(b)(ii) hereof, provided that no payment in excess of $25,000 shall be made in respect of any single item of such expenses referred to in Section 1(b)(ii) above without the prior written approval of National.

(f) Promptly upon completion of TSC's liquidation, TSC shall transfer to Transferee, without payment of any additional consideration, (i) the books and records excluded from delivery pursuant to Section 1(b(i), and (ii) the cash, if any, remaining after provision for the payment of all expenses, taxes, costs and amounts referred to in Section1(b)(ii). Until such transfer the duly authorized representatives of National shall have access during regular business hours to inspect such books and records.

2. *Payment of Purchase Price*

(a) In exchange for the business and assets of TSC, on the Closing Date National will:

(i) issue to TSC: (A) .6 share of National $1.25 Series B Cumulative Convertible Preferred Stock ("National Series B Preferred Stock"), and (B) one National Warrant entitling the holder to purchase one share of National Common Stock at a price of $21.40 per share at any time on or before October 31, 1978 ("National Warrant"), for each share of $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1 of TSC ("Series 1 Preferred Stock") outstanding on the Closing Date;

(ii) issue to TSC: (A) .5 share of National Series B Preferred Stock, and (B) 1.5 National Warrants for each share of Common Stock of TSC outstanding on the Closing Date;

(iii) deliver to TSC an undertaking whereby Transferee assumes and agrees to pay, perform and discharge all debts, obligations, liabilities and agreements of every kind and description, whether absolute or contingent of TSC, as the same shall exist on the Closing Date subject only to the limitation, however, that Transferee shall not assume, pay, perform or discharge (A) any liabilities for expenses incurred by TSC in connection with, or resulting from or attributable to, the transactions contemplated by this Agreement, including expenses of dissolution and liquidation, or (B) liabilities arising out of activities undertaken by TSC subsequent to the Closing Date, or (C) the obligations of TSC to distribute the National securities to its stockholders; and

(iv) in the event that as of the Closing TSC has not issued the additional shares required to satisfy the provisions of Article I of an Agreement, dated as of April 2, 1968, between TSC and the former Shareholders of SAS, Inc., National will assume TSC's obligation as in said Article I provided by agreeing in writing to issue an equivalent number of its securities based on the exchange ratio set forth in Section 2(a)(i) above, and an assumption (or substitution of new options, as the case may be) of all outstanding restricted and qualified stock options to purchase stock of TSC held by employees of TSC or its subsidiaries on the Closing Date so that such options shall be replaced with options to purchase the maximum number of shares of National Common Stock at the lowest price per share as shall be permitted by Sections 422(a)(2), 424(a)(2) and 425 of the Internal Revenue Code of 1954, as amended, and the regulations promulgated thereunder, without such assumption (or substitution) being considered a modification, extension or renewal as defined therein.

(b) If either the number of shares of National Series B Preferred Stock or number of National Warrants deliverable to TSC hereunder includes a fraction of a share or warrant, as the case may be, National shall issue to TSC the next highest whole number of shares or warrants, as the case may be.

(c) The terms and provisions of the National Capital Stock, the National Series B Preferred Stock and the National Warrant are set forth in the Appendices 1, 2 and 3, respectively, to this Agreement.

3. *Representations and Warranties of TSC*

TSC represents and warrants to National that:

(a) TSC is a corporation duly organized, validly existing and in good standing under the laws of Delaware.

(b) Each of TSC's subsidiaries is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation.

(c) TSC is duly authorized to issue 3,000,000 shares of Preferred Stock in series and 5,000,000 shares of Common Stock, of which on October 10, 1969, 911,513 shares of Series 1 Preferred Stock and 1,852,603 shares of Common Stock were validly issued and outstanding. As of October 10, 1969 an aggregate of 62,000 shares of Series 1 Preferred Stock were reserved for issuance upon exercise of employee restricted or qualified stock options granted or assumed by TSC, and for issuance to the former Shareholders of SAS, Inc. pursuant to an Agreement dated April 2, 1968. Additionally, an aggregate of 781,135 shares of Common Stock were reserved for issuance upon conversion of shares of Series 1 Preferred Stock now or hereafter outstanding, and upon exercise of employee restricted or qualified stock options granted or assumed by TSC. There are no other options or rights to acquire any securities of TSC except for those shares of capital stock reserved as aforesaid.

(d) The execution and delivery of this Agreement by TSC and consummation of the transaction contemplated hereby has been duly and validly authorized by its Board of Directors, subject to approval by the stockholders of TSC, and, subject to the satisfaction of the terms and conditions hereof, the consummation of said transaction will have been duly and validly authorized by all necessary and appropriate corporate action on the part of TSC, and this Agreement will be binding upon and enforceable against TSC in accordance with its terms.

(e) The information provided or to be provided in writing by TSC to National for use in the proxy statement to be used by National in connection with the stockholders' meeting referred to in Section 5(a)(ii) hereof does not or will not contain any statement which, at the time and in light of the circumstances in which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements made not false or misleading.

4. *Representations and Warranties of National*

National represents and warrants to TSC as follows:

(a) National is a corporation duly organized, validly existing and in good standing under the laws of Kentucky.

(b) The execution and delivery of this Agreement by National and the consummation of the transaction contemplated hereby has been duly and validly authorized by its Board of Directors, subject to approval by the stockholders of National, and, subject to the satisfaction of the terms and conditions hereof, the consummation of said transaction will have been duly and validly authorized by all necessary and appropriate corporate action on the part of National, and this Agreement will be binding upon and enforceable against National in accordance with its terms.

(c) As referred to above, National intends to form a wholly-owned subsidiary, Transferee, to acquire the assets, properties and business of TSC and to assume the liabilities of TSC contemplated hereunder. When formed such subsidiary will be duly organized, validly existing and in good standing under the laws of the state of its incorporation, will have adequate corporate power to carry out its obligations under this Agreement, and will duly authorize the acquisition of the assets and the assumption of liabilities of TSC as herein provided.

(d) On the Closing Date the shares of National Series B Preferred Stock, the National Warrants, and the National Common Stock reserved for issuance upon the conversion or exercise of

any such securities will have been duly authorized; the National securities will be legally and validly issued; and the National Series B Preferred Stock and the National Common Stock issued upon the conversion thereof or the exercise of the National Warrants when issued or delivered pursuant to this Agreement will be fully paid and non-assessable, and no stockholder of National will have any preemptive right of subscription or purchase in respect thereof.

(e) The information provided or to be provided in writing by National to TSC for use in the proxy statement to be used by TSC in connection with the stockholders' meeting referred to in Section 5(b)(ii) hereof does not or will not contain any statement which is, at the time and in light of the circumstances in which it is made, false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements made not false or misleading.

5. *Further Agreements*

(a) National agrees that:

(i) National will permit TSC and its representatives to have full access to the books and records of National and its subsidiaries, other than portions thereof which National deems to be confidential in nature and such as would prejudice the interest of National within the business areas in which it operates.

(ii) National will take all steps necessary to call a special meeting of its stockholders to be held on December 1, 1969, or as soon as practicable thereafter. At such special meeting, the stockholders will be requested to consider and approve the terms of this Agreement and authorize the transactions contemplated hereby, and to approve and adopt an amendment to National's Restated Articles of Incorporation, increasing the number of authorized shares of National Common Stock from 12,000,000 to 20,000,000 shares.

(iii) Pending the Closing, TSC shall have complete control over its affairs and the management of its business, subject to the provisions of Section 5(b) hereof.

(iv) National will take such action and execute and deliver such instruments as shall be necessary or desirable to accomplish the assumption by National of its agreements and undertakings set forth in Section 2(a)(iv) hereof.

(v) National will cause Transferee to take such action and execute and deliver such instruments as shall be necessary or desirable to accomplish the assumption by Transferee of the liabilities of TSC as provided in Section 2(a)(iii) hereof.

(vi) National agrees, prior to the Closing Date, to use its best efforts to obtain the authorization for listing on the New York Stock Exchange and the American Stock Exchange, as the case may be, upon official notice of issuance, of the shares of National Series B Preferred Stock, the National Warrants, and National Common Stock to be issued or reserved for issuance pursuant to this Agreement.

(vii) If between the date hereof and the Closing Date, an adjustment or adjustments are made in the conversion rate of National Series B Preferred Stock or the exercise price of National Warrants, a like adjustment or adjustments shall be made with respect to the National Series B Preferred Stock and/or National Warrants deliverable hereunder.

(b) TSC agrees that:

(i) TSC will permit National and its representatives to have full access to the books and records of TSC and its subsidiaries, other than portions thereof which TSC deems to be confidential in nature and such as would prejudice the interest of TSC within the business areas in which it operates.

(ii) TSC will take all steps necessary to call a special meeting of its stockholders to be held on December 1, 1969, or as soon as practicable thereafter. At such special meeting, the stockholders will be requested to (a) approve and adopt an amendment to the Certificate of Incorporation modifying the liquidation rights of holders of Preferred Stock and Series 1 Preferred Stock to provide that the exchange of National securities for shares of Series 1 Preferred Stock as provided in Section 2(a)(i) hereof shall constitute the only assets of the corporation to which the holders of Series 1 Preferred Stock are entitled upon liquidation of TSC in accordance with the provisions of this Agreement and modifying the conversion rights of the holders of Series 1 Preferred Stock by terminating their rights to convert as of the last regular business day prior to the Closing Date; (b) approve and adopt the Plan of Complete Liquidation of TSC heretofore adopted by TSC's Board of Directors providing for, among other things, the complete liquidation and dissolution of TSC within a 12-month period beginning on the date of such stockholders' meeting, all in accordance with the provisions of Section 337 of the Internal Revenue Code; (c) approve the terms of this Agreement and the transactions contemplated hereby; and (d) approve and adopt an amendment to the Certificate of Incorporation changing its name to a name dissimilar to TSC Industries, Inc.

(iii) TSC agrees that prior to the Closing Date it will not, and it will not permit any subsidiary to, encumber any asset or enter into any transaction or make any commitment relating to the assets and business of TSC or any of its subsidiaries, otherwise than in the ordinary course of its business, without first obtaining the written consent of National.

(iv) Pending consummation of the transactions contemplated hereby, TSC will not sell, transfer or otherwise dispose of the capital stock of any of its subsidiaries, or cause or permit any such subsidiary to issue any additional shares of its capital stock or issue any securities convertible into such capital stock or sell, transfer or dispose of all or substantially all of its assets and business or merge or consolidate with any other corporation, in each case other than to or into TSC or a wholly-owned subsidiary of TSC.

(v) Pending consummation of the transactions contemplated hereby, TSC will not, without the prior written consent of National, (A) increase (or take any actions which contemplate a future increase in) the number of its issued shares (except for the issuance of those shares reserved for issuance as set forth in Section 3(c) hereof) or its stock options, (B) declare or pay any dividend in excess of regular quarterly dividend of $.175 per share of Series 1 Preferred Stock, (C) declare or pay any dividend on its Common Stock, or (D) except as contemplated by this Agreement, amend its Certificate of Incorporation, or amend its By-Laws, or merge or consolidate with another corporation, or change the rights of the holders of its Preferred Shares, Common Shares or other securities.

(vi) TSC will, on the Closing Date or as soon thereafter as is practicable, but in any case within 12 months from the date of the TSC stockholders' meeting held in conformity with the provisions of this Agreement, take appropriate steps in accordance with the laws of the State of Delaware and in compliance with Section 337 of the Internal Revenue Code to liquidate completely and distribute the shares of National Series B Preferred Stock and National Warrants then held by TSC to the holders of shares of capital stock of TSC entitled thereto upon surrender of their TSC stock certificates, and thereafter to dissolve. However, TSC will not distribute in liquidation the National securities to the former shareholders of SAS, Inc. in exchange for 40,000 shares of Series 1 Preferred Stock if such shares are issued to said former SAS, Inc. shareholders by TSC on or prior to the Closing Date, until six months from the Closing Date or 365 days from the TSC stockholders meeting referred to in paragraph 5(b)(ii) hereof, whichever first occurs. Provisions consistent with the foregoing covenant shall be contained in the Plan of Complete Liquidation to be submitted to the TSC stockholders, and in the instructions to the Exchange Agent hereinafter referred to. In connection with such liquidation and the distribution of National Securities, any stockholder of TSC entitled to a fractional interest shall be afforded an opportunity for 60 days from the Closing Date upon surrender of his TSC stock

certificate, to sell or purchase a sufficient fractional interest to make up a full share of National Series B Preferred Stock or a full National Warrant, as the case may be. As soon as practicable after the close of such 60-day period, shares of National Series B Preferred Stock and National Warrants sufficient to cover fractional interests for which buy or sell instructions have not been received will be sold for the account of the holders of such fractional interests and the proceeds held for the TSC stockholders entitled thereto. TSC will make appropriate arrangements, as authorized by its stockholders, for the appointment of a bank or trust company to act as agent of each TSC stockholder entitled to a fractional interest for the purpose of buying or selling fractional interests in accordance with the provisions of this Section 5(b)(vi).

(vii) Holders of certificates representing shares of TSC Common Stock or Series 1 Preferred Stock will not receive certificates for or have any voting, dividend or other rights with respect to shares of National Series B Preferred Stock or certificates representing National Warrants to which they are entitled except upon surrender of their TSC stock certificates. Upon request of National at any time after the sixth anniversary of the Closing Date, the Exchange Agent, pursuant to the instructions given to it, shall surrender to National all shares of National Series B Preferred Stock and accumulated dividends thereon, all National Warrants and the proceeds of all fractional interests then unclaimed by the stockholders of TSC originally entitled thereto. After the surrender thereof to National, National shall distribute such shares, warrants and cash to the TSC stockholders entitled thereto, but only upon surrender by TSC stockholders of their TSC Stock. National shall indemnify TSC, its officers and directors, and the Exchange Agent, its officers and directors, from any liability resulting from National's failure to make distribution of the National Series B Preferred Stock, National Warrants and cash surrendered to it pursuant to this Section 5(b)(vii).

6. *Termination of Agreement*

This Agreement and the transactions contemplated hereby may be terminated at any time prior to the Closing Date, whether before or after the meeting of TSC's or National's stockholders:

(a) by mutual consent of the Boards of Directors of National and TSC;

(b) by the Board of Directors of either National or TSC if such Board shall have determined in its sole discretion that the transactions contemplated by this Agreement have become inadvisable or impracticable by reason of the institution or threat by state, local or federal governmental authorities or by any other person, of material litigation or proceedings against TSC or National;

(c) by the Board of Directors of either TSC or National if the holders of their respective debt instruments, or any bank or other lender shall not have given any approval or consent necessary for the consummation of the transactions contemplated by this Agreement, unless such debts shall be paid or otherwise provided for;

(d) by the Board of Directors of either TSC or National, if the New York Stock Exchange shall not have approved for listing, upon official notice of issuance, all of the shares of National Series B Preferred Stock to be issued and delivered at the Closing and all of the shares of National Common Stock which are contemplated to be reserved for issuance pursuant to the terms of this Agreement; or the American Stock Exchange shall not have approved for listing, upon official notice of issuance, all of the National Warrants to be issued and delivered at the Closing;

(e) by the Board of Directors of National if the business, assets, financial condition or results of operations of TSC and subsidiaries taken as a whole have been materially and adversely affected, by reason of changes or developments or operations in the ordinary course of business or otherwise;

(f) by the Board of Directors of TSC if the business, assets, financial condition or results of operations of National and its subsidiaries taken as a whole have been materially and adversely affected, by reason of changes or developments or operations in the ordinary course of business or otherwise;

(g) by the Board of Directors of either National or TSC if the stockholders of TSC or National shall not have approved the matters required to be submitted to a vote of such stockholders pursuant to the provisions of this Agreement.

7. Conditions Precedent to Obligations of National

The obligations of National to consummate the transaction contemplated by this Agreement are subject to the satisfaction on or prior to the Closing of the following conditions:

(a) All of the terms, agreements and conditions to be complied with or performed by TSC on or before the Closing pursuant to the terms of this Agreement shall have been duly complied with or performed; all representations and warranties made by TSC which are contained in this Agreement shall be true and correct in all material respects at the Closing as though such representations and warranties were made on such date; and since July 31, 1969 there shall have been no material adverse change in the business, operation or financial condition of TSC and its subsidiaries, taken as a whole.

(b) The execution, delivery and consummation of this Agreement will not result in any breach of or constitute a default (or an event which, with notice or lapse of time, or both, would become a default) under any bank loan agreement to which TSC or any of its subsidiaries is a party or by which any of them may be bound, unless such debt is paid or otherwise provided for to National's satisfaction.

(c) National shall have received the opinion of its counsel to the effect that all legal matters relating to the consummation of the transactions contemplated hereby have been completed to the satisfaction of such counsel in all material respects.

(d) A favorable opinion of Messrs. Friedman, Koven, Shapiro, Salzman, Koenigsberg, Specks & Homer, counsel for TSC, shall have been delivered to National, dated as of the Closing, in form and substance satisfactory to National and its counsel, to the effect that:

(i) TSC and its subsidiaries are each corporations duly organized, validly existing and in good standing under the laws of their respective jurisdictions of incorporation;

(ii) TSC has corporate power to consummate the transactions contemplated by this Agreement and has taken all action required by Delaware law, its Certificate of Incorporation, and its By-Laws to authorize it to do so;

(iii) This Agreement has been duly executed and delivered by TSC and constitutes a valid and binding obligation of TSC in accordance with its terms;

(iv) The execution and delivery of this Agreement did not, and the consummation of the transactions contemplated hereby will not, result in any breach of or constitute a default (or an event which, with notice or lapse of time, or both, would become a default) under any bank loan agreement known to such counsel and to which either TSC or any of its subsidiaries is a party or by which any of them may be bound.

(v) Except for the requirements of Bulk Sales Laws of any applicable jurisdiction, the instruments delivered by TSC to National or Transferee at the Closing under this Agreement validly and effectively transferred to National or Transferee all of the Purchased Assets in accordance with the terms of such instruments and of this Agreement.

In rendering their opinion, such counsel may rely on opinions of local counsel, certificates of officers of TSC and its subsidiaries and such other evidence as they may deem necessary or desirable. Such counsel need give no opinion as to the condition of title to real estate, if any, included in the Purchased Assets.

The satisfaction of any of the foregoing conditions may be waived in writing by National.

8. Conditions Precedent to Obligations of TSC

The obligations of TSC to consummate the transactions contemplated by this Agreement are subject to the satisfaction on or prior to the Closing of each of the following conditions:

(a) All of the terms, agreements and conditions to be complied with or performed by National and Transferee on or before the Closing pursuant to the terms of this Agreement shall have been duly complied with or performed; all representations and warranties made by National which are contained in this Agreement shall be true and correct in all material respects at the Closing as though such representations and warranties were made on such date; and since September 30, 1969, there shall have been no material adverse change in the business, operation or financial condition of National and its subsidiaries, taken as a whole.

(b) The execution, delivery, and consummation of this Agreement will not result in any breach of or constitute a default (or an event which with notice or lapse of time, or both, would become a default) under any note or loan agreements to which National or any of its subsidiaries is a party or by which any of them may be bound, unless such debt is paid or otherwise provided for to TSC's satisfaction.

(c) TSC shall have received the opinion of its counsel to the effect that all legal matters relating to the consummation of the transactions contemplated hereby have been completed to the satisfaction of such counsel in all material respects.

(d) A favorable opinion of Messrs. Greenebaum, Grissom, Doll, Matthews & Boone, counsel for National, shall have been delivered to TSC, dated as of the Closing, in form and substance satisfactory to TSC and its counsel, to the effect that:

(i) Transferee has been duly organized, and is validly existing and in good standing under the laws of the State of its incorporation.

(ii) Transferee has corporate power to consummate the transactions contemplated by this Agreement, including the assumption of liabilities of TSC as provided herein, and has taken all action required by the laws of the State of its incorporation, its Certificate of Incorporation and its By-Laws to authorize it to do so.

(iii) National is a corporation duly organized, and is validly existing and in good standing under the laws of Kentucky;

(iv) National has corporate power to consummate the transactions contemplated by this Agreement and has taken all action required by Kentucky law, its Restated Articles of Incorporation and its By-Laws to authorize it to do so;

(v) This Agreement has been duly executed and delivered by National and constitutes a valid and binding obligation of National in accordance with its terms;

(vi) The execution and delivery of this Agreement did not, and the consummation of the transactions contemplated hereby will not, result in any breach of or constitute a default (or an event which, with notice or lapse of time, or both, would become a default) under any note or loan agreement known to such counsel and to which National or any of its subsidiaries is a party or by which any of them may be bound;

(vii) All National securities, when delivered pursuant to this Agreement, will be validly issued and its shares issued pursuant to this Agreement or upon conversion of the National Series B Preferred Stock or upon exercise of the National Warrants will be fully paid and non-assessable;

(viii) The delivery of the National securities to TSC hereunder, the distribution of such securities by TSC to its stockholders pursuant to this Agreement, and the sale or transfer of such securities by said stockholders do not require the filing of a registration statement under the Securities Act of 1933; provided, however, said counsel may assume that TSC and any of its affiliates, as that term is defined in Rule 133 of the General Rules and Regulations

under said Securities Act, have not acquired the National securities with a view to the distribution thereof except in compliance with the requirements of said Act.

In rendering their opinion, such counsel may rely on opinions of local counsel, certificates of officers of National, and such other evidence as they may deem necessary or desirable.

(e) Not later than the Closing Date, TSC, with respect to any loan agreements with banks or other lenders which are guaranteed by TSC, shall have been completely released from any liability TSC may have under such loan agreements or shall have been properly indemnified by National, and all conditions required by any of such instruments, guarantees and agreements to be satisfied in connection with a sale of the assets of TSC shall have been duly satisfied.

The satisfaction of any of the foregoing conditions may be waived in writing by TSC.

9. *Closing and Closing Date*

The consummation of the transactions contemplated by this Agreement (herein called the "Closing", "Date of Closing", or "Closing Date"), shall take place at a time as soon as practicable after all of the conditions contained herein shall have been satisfied. The Closing shall be held in Chicago Illinois, or such other place as the parties may agree upon.

10. *Non-Assignable Assets*

Nothing in this Agreement shall be construed as an attempt (or a representation or warranty of corporate power) to sell, convey, assign, transfer or deliver:

(1) any asset which is by law non-assignable without the consent of any other person unless such consent shall have been given; or

(2) any contract, license, permit or other asset as to which substantially all of the benefits thereunder and substantially all of the remedies for the enforcement thereof would not, as a matter of law, vest in Transferee under the transfer and assignment provided for by this Agreement in the absence of further consent by any governmental organization.

To the extent any such purported sale, conveyance, assignment, transfer or delivery occurs, and such matter is not otherwise provided for in the closing documents of transfer, the assets concerned shall be deemed to be held by TSC in trust for Transferee, pending further arrangements with respect thereto. TSC agrees, if requested by National or Transferee, to use its best efforts to obtain all such consents, and, if any such consent shall not have been obtained, TSC shall, at the request and expense and under the direction of National or Transferee, cooperate with National or Transferee in any reasonable arrangement designed to provide for Transferee the benefits under any such asset or any such contract, license, permit or other asset.

11. *Action on Closing Date*

(a) TSC shall deliver to Transferee all such duly executed documents and instruments of transfer as are necessary or appropriate to vest in Transferee title to and the right to use and enjoy the Purchased Assets.

(b) National shall cause Transferee to deliver to TSC all such duly executed documents and instruments of assumption as are necessary or appropriate to evidence the assumption by Transferee of the liabilities and obligations of TSC pursuant to Section 2(a)(iii) of this Agreement.

(c) National shall deliver to TSC all such duly executed documents and instruments of assumption as are necessary or appropriate to evidence the assumption by National of the liabilities and obligations of TSC pursuant to Section 2(a)(iv).

(d) National shall deliver to TSC the National securities which it is required to deliver under the terms of this Agreement.

(e) There shall be delivered all other agreements, instruments and documents which, by the terms of this Agreement, are to be executed and delivered on or before the Closing Date.

12. *Action After Closing*

(a) Subject to the provisions of Section 5(b)(vi) hereof, TSC shall distribute as soon as practicable after the Closing to the Exchange Agent, who shall also act as liquidating trustee, for and on behalf of the stockholders of TSC the National securities received as part of the purchase price. Except as provided in the foregoing sentence, and except as required to complete the liquidation and dissolution of TSC, from and after the Closing TSC shall not engage in any business or other activity.

(b) After the Closing, TSC will execute and deliver from time to time at the request and at the expense of National, all such further instruments, assignments and assurances and will perform all such other acts as may be required to vest in and confirm to Transferee title to and the right to use and enjoy the Purchased Assets.

(c) After the Closing, National will cause Transferee to preserve and retain the books and records transferred to Transferee by TSC, and the books and records of TSC's subsidiaries, for such period as may be required by law.

(d) After the Closing, National will cause Transferee to execute and deliver from time to time at the request of TSC and at National's expense all such further instruments and assurances and will perform all such other acts as may be required to evidence the assumption or confirm the assumption by Transferee of the debts, obligations, contracts, commitments and liabilities of TSC and Transferee's obligation to pay, perform and discharge such debts, obligations, contracts, commitments and liabilities.

(e) After the Closing, National will cause Transferee to pay and discharge, or deliver to TSC, sufficient funds to enable TSC to pay and discharge all debts, liabilities and expenses incurred by TSC in carrying out the provisions of this Agreement to the extent that the amount retained by TSC under Section 1(b)(ii) of this Agreement is insufficient therefor.

13. *Miscellaneous*

(a) The representations and warranties contained in this Agreement, all of which are set forth in Sections 3 and 4 of this Agreement, shall not survive the Closing.

(b) To the extent legally permissible, National waives compliance by TSC with the so-called Bulk Sales Act or other similar law of any jurisdiction in connection with any of the transactions contemplated by this Agreement.

(c) Any notices or other communications required or permitted under this Agreement shall be sufficiently given if sent by prepaid first class certified air mail, return receipt requested, addressed as follows, or if personally delivered, as follows:

If to National: National Industries, Inc.
(Attention: Mr. Stanley R. Yarmuth, President)
510 West Broadway
Louisville, Kentucky 40202

with a copy to: Messrs. Greenebaum, Grissom, Doll, Matthews & Boone
614 Kentucky Home Life Building
Louisville, Kentucky 40202

If to TSC: TSC Industries, Inc.
(Attention: Mr. Richard H. Schaefer, President)
4747 North Ravenswood Avenue
Chicago, Illinois 60640

with a copy to: Friedman, Koven, Shapiro, Salzman, Koenigsberg, Specks & Homer
(Attention: Mr. Charles N. Salzman)
208 South La Salle Street
Chicago, Illinois 60604

or such other addresses as shall be furnished in writing by either party, and any such notice or communication shall be deemed to have been given as of the second day following the date of such mailing, or on the date of such personal delivery.

(d) This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns.

(e) The Section headings of this Agreement are inserted only as a matter of convenience, and for ease of reference, and are not a part of this Agreement.

(f) This Agreement supersedes all prior oral and written agreements with respect to the subject matter hereof. Neither this Agreement nor any provision hereof may be changed, waived, discharged or terminated except by a statement in writing signed by the party against which enforcement of the change, waiver, discharge or termination is sought.

(g) All printing costs of this Agreement shall be shared equally between the parties. All other fees and expenses of the transaction incurred by each of the parties, respectively, shall be borne by such party.

(h) For the purposes of this Agreement, the words "subsidiary" and "subsidiaries" shall be deemed to include subsidiaries of subsidiaries.

(i) This Agreement may be executed in one or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other party.

IN WITNESS WHEREOF, each of the parties has caused this Agreement to be executed on its behalf by its officers thereunto duly authorized as of the date first above written.

NATIONAL INDUSTRIES, INC.

(SEAL)

By ALLAN B. SOLOMON
Vice President

Attest:

GERALD H. WEINSTEIN
Secretary

TSC INDUSTRIES, INC.

(SEAL)

By RICHARD H. SCHAEFER
President

Attest:

LAWRENCE W. SCHWEIK
Secretary

APPENDIX 1*

NATIONAL INDUSTRIES, INC.

Article V of Articles of Incorporation of National Industries, Inc. pertaining to the Preferred Stock and the Common Stock which National Industries, Inc. has authority to issue.

The total number of shares of all classes of stock which the Corporation shall have authority to issue is 17,000,000, of which 5,000,000 shares shall be Preferred Stock (hereinafter called the Preferred Stock), of the par value of $1.00 per share, and 12,000,000 shares shall be Common Stock (hereinafter called the Common Stock), of the par value of $1.00 per share.

The designations, powers, preferences and rights, and the qualification, limitations and restrictions, of each class of stock of the Corporation which are fixed by these Articles of Incorporation, and the express grant of authority to the Board of Directors to fix by resolution or resolutions such designations, powers, preferences and rights, and such qualifications, limitations and restrictions, of the Preferred Stock as are not fixed by these Articles of Incorporation, are as follows:

(1) The Preferred Stock may be issued from time to time in any amount (not exceeding in the aggregate, including all shares theretofore issued and then outstanding of any and all series thereof, the total number of shares of the Preferred Stock hereinabove authorized) as Preferred Stock of one or more series. All shares of any one series of the Preferred Stock shall be identical in all respects, each series thereof shall be distinctively designated by letter or descriptive words and, except as permitted by the provisions of Section (2) of this Article V, all series of the Preferred Stock shall rank equally and be identical in all respects.

(2) To the extent not stated and expressed in this Article V, authority is hereby expressly granted to the Board of Directors from time to time to issue the Preferred Stock as Preferred Stock of any series and, in connection with the creation of each such series, to fix by the resolution or resolutions providing for the issue of shares thereof the number of shares of such series and the designations, powers, preferences and rights, and the qualifications, limitations and restrictions, of such series, to the full extent now or hereafter permitted by the laws of the Commonwealth of Kentucky, in respect of the following matters:

(a) The designation of such series;

(b) The dividend rate of such series;

(c) The price at, and the terms and conditions on which, the shares of such series may at the election of the Corporation be redeemed;

(d) The terms and conditions on which the shares of such series may be converted in the event the shares of such series are issued with the privilege of conversion;

(e) The amount payable upon shares of such series in the event of voluntary or involuntary liquidation; and

(f) The provisions, if any, for sinking funds, purchase funds and redemption of shares; except that the Board of Directors shall not create a sinking fund in respect of any series unless provisions for a sinking fund at least as beneficial to all issued and outstanding shares of the Preferred Stock shall either then exist or be at the same time created.

(3) The powers, preferences and rights, and the qualifications, limitations and restrictions, applicable to the Preferred Stock of all series are as follows:

* As set forth in paragraph 5(a)(ii) of the Agreement, the shareholders of National will be requested to adopt an amendment to National's Restated Articles of Incorporation increasing the authorized common stock from 12,000,000 to 20,000,000 shares. The adoption of such amendment is a condition precedent to the consummation of the transactions contemplated by the Agreement.

(a) (i) Out of funds of the Corporation legally available for dividends, the holders of the Preferred Stock of each series shall be entitled to receive, when and as declared by the Board of Directors, cumulative dividends at the rate determined and on the dividend dates fixed by resolution of the Board of Directors as provided in Section (2) of this Article V for such series, and no more (each dividend payment date being hereinafter called a dividend date and each period ending with a dividend date being hereinafter called a dividend period). Dividends on shares of the Preferred Stock shall accrue on a daily basis from the dividend date immediately preceding the date of issuance (unless the date of issuance shall be a dividend date, in which case they shall accrue from that date) or from such other date or dates as may be fixed by the Board of Directors for any series. Unless dividends at the rate prescribed for each series shall be declared and paid or set apart for payment in full on all outstanding shares of Preferred Stock for all past dividend periods and for the current dividend period, no dividends shall be declared or paid upon the Common Stock and no sum or sums shall be set aside pursuant to subdivision (d) of this Section (3) for the redemption of Preferred Stock of any series. Accrued and unpaid dividends on the Preferred Stock shall not bear interest.

(ii) All dividends declared on the Preferred Stock on any dividend date shall be declared pro rata so that the amounts of dividends per share declared on such date on the Preferred Stock of different series that were outstanding on such date shall in all cases bear to each other the same proportions that the respective dividend rates of such series on such date bear to each other.

(b) Out of any funds of the Corporation legally available for dividends and remaining after full cumulative dividends upon the Preferred Stock of all series then outstanding shall have been paid or set aside for all past dividend periods and for the current dividend period, then, and not otherwise, the holders of the Common Stock shall, subject to the provisions hereof, be entitled to receive such dividends as may from time to time be declared by the Board of Directors.

(c) (i) The Preferred Stock of all series shall be preferred over the Common Stock as to assets in the event of any liquidation, dissolution or winding up of the Corporation. In that event and before any distribution of the assets shall be made to the holders of the Common Stock the holders of the Preferred Stock of each series shall be entitled to receive, out of the assets of the Corporation available for distribution to its stockholders, the amount determined by the Board of Directors as provided in Section (2) of this Article V for every share of their holdings of the Preferred Stock of such series, plus, in each case, a further amount per share equal to all accrued and unpaid dividends thereon to the date payment is made available to the holders of the Preferred Stock. If, in the event of any such liquidation, dissolution or winding up, the holders of all series of the Preferred Stock shall have received all the amounts to which they shall be entitled as aforesaid, the holders of the Common Stock shall be entitled, to the exclusion of the holders of the Preferred Stock of all series, to share ratably in all the assets of the Corporation available for distribution to the remaining stockholders according to the number of shares of the Common Stock held by them upon such distribution.

(ii) If, upon any such dissolution, liquidation or winding up of the Corporation, the assets distributable among the holders of the shares of Preferred Stock shall be insufficient to permit the payment in full to such holders of the preferential amounts referred to in subdivision (c)(i) hereof, then the entire assets of the Corporation shall be distributed among the holders of the outstanding shares of Preferred Stock ratably, in proportion to the preferential amounts to which they shall be entitled respectively. Neither the consolidation or merger of the Corporation with or into any other corporation or corporations, the sale or lease of all or substantially all the assets of the Corporation, nor the merger or consolidation of any other corporation into and with the Corporation shall be deemed to be a liqui-

dation, dissolution or winding up of the Corporation within the meaning of any of the provisions of this subdivision (c).

(iii) The requirement for payment of any preferential amount due upon the liquidation, dissolution or winding up of the Corporation shall not restrict the use of the Corporation's surplus or current net profits for payment of dividends upon the Preferred Stock and Common Stock or for any other lawful purpose.

(d) (i) All the Preferred Stock or any series thereof, or any part of any series thereof, at any time outstanding, may be redeemed by the Corporation, at the time or times, to the extent and at an amount determined by the Board of Directors as provided in Section (2) of this Article V for such series, plus, in each case, an amount equal to accrued and unpaid dividends thereon to the date designated for redemption and upon such other terms not inconsistent herewith. However, no Preferred Stock may be redeemed unless full cumulative dividends upon the Preferred Stock of all series then outstanding shall have been paid or shall then be paid for all past dividend periods. If less than all the outstanding Preferred Stock of any series is to be redeemed, the redemption may be made either by lot or pro rata or in such other fair and equitable manner as may be prescribed by the Board of Directors.

(ii) Notice of redemption (which shall include a description of the conversion rights, if any) shall be mailed or caused to be mailed by the Corporation addressed to each holder of record of shares to be redeemed, at his last address as it appears on the books of the Corporation, at least 30 days prior to the date designated for redemption. If such notice of redemption shall have been duly mailed, or irrevocable instructions to effect such mailing shall have been given to the Transfer Agent or Agents for such shares, and if on or before the redemption date named in such notice all funds necessary for such redemption shall have been deposited with a bank or trust company, having capital and surplus of at least $5,000,000, for the account of the holders of the Preferred Stock entitled thereto, then on the redemption date all dividends on the Preferred Stock called for redemption shall cease to accrue. Such deposit shall be deemed to constitute full payment of the shares of Preferred Stock to be redeemed and from and after the date of deposit such shares shall be deemed to be no longer outstanding and the holders thereof shall cease to be stockholders with respect to such shares and shall have no rights with respect thereto, except the right to receive the redemption price as hereinbefore provided and the right, if and to the extent determined by the Board of Directors as provided in Section (2) of this Article V for the holders of such series to convert such shares thereof into other securities of the Corporation.

(iii) After the deposit of such amount with such bank or trust company, the respective holders of record of the Preferred Stock to be redeemed shall be entitled to receive the redemption price, without interest, at any time upon actual delivery to such bank or trust company of certificates in transferable form for the number of shares to be redeemed. Any monies so deposited which shall remain unclaimed by the holders of such Preferred Stock at the end of six (6) years after the redemption date, together with any interest thereon which shall be allowed by the bank or trust company with which the deposit shall have been made, shall to the extent permitted by law be paid by such bank or trust company to the Corporation.

(iv) The shares of Preferred Stock redeemed pursuant to the provisions of this subdivision shall have the status of authorized but unissued shares of Preferred Stock and as such may be redesignated and reissued.

(e) All Common Stock and Preferred Stock shall be voting stock. All holders of Common and Preferred Stock shall be entitled to one vote per share held on all matters which shall come before the stockholders, and upon which they shall by law be entitled to vote. Except as otherwise provided by law or the Articles of Incorporation of the Corporation, the holders of Preferred Stock shall vote with the holders of the Common Stock, as one class,

and not as a separate class or series. In addition, the holders of Preferred Stock shall have the following voting rights:

(i) If at the time of any annual meeting of stockholders of the Corporation for the election of directors, a "default" (as hereinafter defined) shall exist with respect to the payment of dividends to the holders of all series of the Preferred Stock, such holders voting separately as a class and without regard to series, shall have the right to elect two members of the Board of Directors. The absence of a quorum of the holders of Common Stock shall not affect the exercise by the holders of Preferred Stock of such voting right. The holders of all of the outstanding Common Stock and Preferred Stock as one class shall be entitled to elect the remaining directors of the Corporation.

(ii) Whenever a default shall exist, the Corporation, upon the written request of the holders of 20% or more of the outstanding shares of all series of Preferred Stock, shall call a special meeting of such holders of Preferred Stock, to be held within 120 days after the date on which such request is received by the Corporation, for the purpose of enabling such holders to elect two members to the Board of Directors. However, such special meeting need not be called if an annual meeting of stockholders of the Corporation for the election of directors shall be scheduled to be held within such 120 days or if the election of such directors may be effected by the written consent of the holders of a majority of the outstanding shares that would be entitled to vote at such special meeting. Prior to any such meeting, the number of directors of the Corporation shall be increased to the extent necessary to provide the vacancies for such two additional directors.

(iii) Such special voting rights of the holders of Preferred Stock and the term of office of the directors elected by them shall cease upon the termination of the default. If, prior to the end of the term of any director elected as aforesaid by the holders of shares of the Preferred Stock, a vacancy in the office of such director shall occur by reason of death, resignation, removal, disability or any other cause, such vacancy shall be filled for the unexpired term by the remaining director previously elected by the holders of the Preferred Stock if there be one then in office and if no such director is then in office, in the manner provided in subdivision (e) (ii) hereof.

(iv) For the purposes of this subdivision (e), a "default" shall be deemed to have occurred whenever the amount of dividends in arrears upon any series of the Preferred Stock shall be equivalent to six quarterly dividends or more, and, having so occurred, such default shall be deemed to exist thereafter until, but only until, all dividends in arrears on all shares of the Preferred Stock, of each and every series, shall have been paid.

(f) (i) So long as any shares of the Preferred Stock shall be outstanding, the Corporation shall not, without the affirmative vote of the holders of two-thirds of the aggregate number of shares of the Preferred Stock at the time outstanding, considered as a class without regard to series,

(A) alter or change the designations, powers, preferences or rights given to the holders of Preferred Stock by these Articles of Incorporation, so as to affect such holders adversely, or

(B) increase the authorized amount of the Preferred Stock, or

(C) authorize or increase the number of shares of any class of stock ranking, either as to payment of dividends or distribution of assets, prior to or on a parity with the Preferred Stock.

(ii) So long as any shares of any series of Preferred Stock shall be outstanding, the Corporation shall not, without the affirmative vote of the holders of two-thirds of the aggregate number of shares of such series at the time outstanding, alter or change the powers,

preferences or rights determined by the Board of Directors as provided in Section (2) of this Article V for such series, so as to affect such holders adversely.

(4) No stockholder of the Corporation shall by reason of his holding shares of any class have any pre-emptive or preferential right to purchase or subscribe for any shares of any class of the Corporation, now or hereafter to be authorized, or any notes, debentures, bonds or other securities convertible into or carrying options or warrants to purchase shares of any class, now or hereafter to be authorized, whether or not the issuance of any such shares, or such notes, debentures, bonds or other securities, would adversely affect the dividends or voting rights of such stockholder, other than such rights, if any, as the Board of Directors in its discretion from time to time may grant, and at such price as the Board of Directors in its discretion may fix, and the Board of Directors may, except as prohibited by this Article V, issue shares of any class of the Corporation, or any notes, debentures, bonds or other securities convertible into or carrying options or warrants to purchase shares of any class, without offering any such shares of any class, either in whole or in part, to the existing stockholders of any class.

APPENDIX 2*

NATIONAL INDUSTRIES, INC.

Certificate of Designation, Powers, Preferences and Rights, and Qualifications, Limitation and Restrictions, of a Series of Preferred Stock by Resolution of the Board of Directors Providing for the Issue of Shares of Preferred Stock Designated "$1.25 Series B Cumulative Convertible Preferred Stock"

NATIONAL INDUSTRIES, INC. (hereinafter called the "Corporation"), a corporation organized and existing under the laws of the Commonwealth of Kentucky, in accordance with the provisions of Section 271.155 of the Kentucky Revised Statues does hereby certify that:

(A) The name of the corporation is National Industries, Inc.

(B) The resolution establishing and designating its $1.25 Series B Cumulative Convertible Preferred Stock and fixing and determining the relative rights and preferences thereof is as follows:

RESOLVED that, pursuant to the authority expressly granted to and vested in the Board of Directors of the Corporation by the provisions of its Amended Articles of Incorporation, the Board of Directors hereby creates a series of the Preferred Stock, par value $1.00 per share, of the Corporation (hereinafter called the "Preferred Stock") to consist of not more than 182,000 shares of the Preferred Stock, and fixes the designation and the powers, preferences and rights, and the qualifications, limitations and restrictions, of the shares of such series (in addition to the powers, preferences and rights, and the qualifications, limitations and restrictions, set forth in the Amended Articles of Incorporation of the Corporation which are applicable to the Preferred Stock of all series) as follows:

(a) The designation of the series of Preferred Stock created by this resolution shall be $1.25 Series B Cumulative Convertible Preferred Stock (hereinafter called the "Series B Preferred Stock"). The shares of the Series B Preferred Stock shall be fully-paid and non-assessable.

(b) The dividend rate of the Series B Preferred Stock shall be $1.25 per share per annum, and shall be paid quarterly at the rate of $.31¼ per share on March 31, June 30, September 30 and December 31, which shall be the dividend dates for such series.

(c) Shares of the Series B Preferred Stock may be redeemed at any time from date of issue at the election of the Board of Directors at a price of $26.00 per share.

(d) In the event of any liquidation, dissolution or winding up of the Corporation, the Series B Preferred Stock shall then receive $26.00 per share.

(e) The shares of the Series B Preferred Stock shall not be entitled to the benefit of any sinking fund or purchase fund.

(f) (i) The shares of the Series B Preferred Stock shall be convertible at the option of the holders thereof into fully paid and non-assessable shares of the Common Stock of the Corporation (hereinafter called the "Common Stock") at the rate of .75 share of the Common Stock for each share of the Series B Preferred Stock.

Such shares shall be converted by giving written notice of the election to convert to any Transfer Agent for such certificates and by surrendering the certificate or certificates for such shares to such Transfer Agent in transferable form. In case of the redemption of any shares of the Series B Preferred Stock, such right of conversion shall end, as to the shares called for redemption, at the close of business on the sixth day prior to the date fixed for redemption, unless default shall be made in the payment of the redemption price. In the event of the liquidation or dissolution of the Corporation, such right of conversion shall end at the close of business on the tenth day prior to the date fixed for the first distribution of the Corporation's assets to the

* Prior to the Closing Date as defined in Section 9 of the Agreement, the Board of Directors of National will increase the number of authorized shares of National Series B Preferred Stock to a number sufficient to permit compliance by National with the provisions of Sections 2(a)(i) and (ii) of the Agreement.

holders of Series B Preferred Stock. Upon conversion, the Corporation shall make no payment or adjustment on account of dividends accrued or in arrears on the shares of Series B Preferred Stock surrendered for conversion.

(ii) The number of shares of the Common Stock into which each share of the Series B Preferred Stock is convertible shall be subject to the following adjustments from time to time and after the happening of each of the following events only as follows:

(A) In case the Corporation shall (1) declare a dividend on the Common Stock payable in shares of the Common Stock, (2) subdivide the outstanding shares of the Common Stock, (3) combine the outstanding shares of the Common Stock into a smaller number of shares, or (4) issue by reclassification of the Common Stock any shares of the Corporation, each holder shall thereafter be entitled upon conversion to receive for each share of the Series B Preferred Stock held by him the number of shares of the Corporation which he would have owned or have been entitled to receive after the happening of that one of the events described above which shall have happened had such share of the Series B Preferred Stock been converted immediately prior to the happening of such event. Such adjustment shall become effective immediately after the opening of business on the day next following (x) the record day of such dividend or (y) the day upon which such subdivision, combination or reclassification shall become effective.

(B) In case the Corporation shall consolidate or merge into or with another corporation, or in case the Corporation shall sell or convey to any other person or persons all or substantially all the property of the Corporation, each holder of the Series B Preferred Stock then outstanding shall have the right thereafter to convert each share held by him into the kind and amount of shares of stock, other securities, cash and property receivable upon such consolidation, merger, sale or conveyance by a holder of the number of shares of Common Stock into which such share might have been converted immediately prior to such consolidation, merger, sale or conveyance, and shall have no other conversion rights. In any such event, effective provision shall be made, in the certificate or articles of incorporation of the resulting or surviving corporation or otherwise or in any contracts of sale and conveyance so that the provisions set forth herein for the protection of the conversion rights of the shares of the Series B Preferred Stock shall thereafter be made applicable.

(C) In case the Corporation shall issue rights to the holders of the Common Stock entitling them to subscribe for or purchase shares of the Common Stock at a price per share less than the current market price per share of the Common Stock (as defined in Subsection (E) below) at the record date thereof, the number of shares of the Common Stock into which each share of the Series B Preferred Stock shall thereafter be convertible shall be determined by multiplying the number of shares of the Common Stock into which such share of the Series B Preferred Stock was theretofore convertible by a fraction, of which the numerator shall be the number of shares of the Common Stock outstanding on the date of issuance of such rights plus the number of additional shares of the Common Stock offered for subscription or purchase, and of which the denominator shall be the number of shares of the Common Stock outstanding on the date of issuance of such rights plus the number of shares of the Common Stock which the aggregate offering price of the total number of shares so offered would purchase at such current market price. Such adjustment shall be made whenever such rights are issued and shall become effective retroactively immediately after the record date for the determination of stockholders entitled to receive such rights.

(D) In case the Corporation shall distribute to all holders of its Common Stock, and not to the holders of Series B Preferred Stock, any assets or evidences of indebtedness of the Corporation of a value per share in excess of 5% of the current market price per share of the Common Stock (as defined in Subsection (E) below) in any consecutive 12-month period or rights to subscribe to its debt securities or equity securities other than Com-

mon Stock, then in each such case the number of shares of Common Stock into which each share of Series B Preferred Stock shall be convertible after the record date for such distribution shall be determined by multiplying the number of shares of Common Stock into which such share of Series B Preferred Stock was theretofore convertible by a fraction, of which the numerator shall be the current market price per share of the Common Stock (as defined in Subsection (E) below) at such record date and of which the denominator shall be the current market price per share of the Common Stock at such record date less the fair value of the portion of the assets or evidences of indebtedness or subscription rights so distributed applicable to one of the outstanding shares of Common Stock. Value shall be determined by the Board of Directors of the Corporation, whose determination shall be conclusive and shall be described in a statement filed with the Transfer Agent or Transfer Agents for such shares of such series and for the Common Stock.

(E) For the purpose of any computation under Subsections (C) and (D) above, the current market price per share of the Common Stock at any date shall be deemed to be the average of the daily closing prices for the twenty consecutive business days commencing thirty-five business days before such record date. The closing price for each day shall be the last reported sales price regular way or, in case no such reported sale takes place on such day, the average of the reported closing bid and asked prices regular way, in either case on the New York Stock Exchange or the American Stock Exchange or, if the Common Stock is not listed on either Exchange, the average of the closing bid and asked prices as furnished by any member of the New York Stock Exchange selected from time to time by the Corporation for the purpose. The term "business day" as used in this Subsection (E) means any day on which such Exchange shall be open for trading.

(F) No fractional share of the Common Stock shall be issued upon any conversion but, in lieu thereof, there shall be paid to each holder of shares of the Series B Preferred Stock surrendered for conversion who but for the provisions of this Subsection (F) would be entitled to receive a fraction of a share on such conversion, as soon as practicable after the date such shares are surrendered for conversion, an amount in cash equal to the same fraction of the market value of a full share of the Common Stock, unless the Board of Directors shall determine to adjust fractional shares by the issue of fractional scrip certificates in some other manner. For such purpose, the market value of a share of the Common Stock shall be the last reported sales price regular way on the day immediately preceding the date upon which the shares are surrendered for conversion, or, in case no such sale takes place on such day, the average of the reported closing bid and asked prices regular way on such day, in either case on the New York Stock Exchange or American Stock Exchange or, if the shares of Common Stock are not listed on either Exchange, the average of the closing bid and asked prices as furnished by any member of the New York Stock Exchange selected from time to time by the Corporation for that purpose.

(G) No adjustment in the number of shares of the Common Stock into which each share of the Series B Preferred Stock is convertible shall be required unless such adjustment would require an increase or decrease of more than 1/10 of a share in the number of shares of the Common Stock into which such share is then convertible, provided, however, that any adjustments which by reason of this subsection (G) are not required to be made shall be carried forward cumulatively and taken into account in any subsequent calculation.

(H) Whenever any adjustment is required in the shares into which each share of the Series B Preferred Stock is convertible, the Corporation shall forthwith (x) keep available at each of its offices and the offices of each of the Transfer Agent or Transfer Agents for such shares of such series and for the Common Stock, a statement describing in reasonable detail the adjustment and the method of calculation used, and (y) cause a copy of such statement to be mailed to the holders of record of the shares of the Series B Preferred Stock.

(iii) The Corporation shall at all times reserve and keep available out of the authorized but unissued shares of the Common Stock the full number of shares of the Common Stock into which all shares of the Series B Preferred Stock from time to time outstanding are convertible, but shares of the Common Stock held in the treasury of the Corporation may in its discretion be delivered upon any conversion of shares of the Series B Preferred Stock.

(iv) Shares of the Series B Preferred Stock converted into Common Stock shall have the status of authorized but unissued shares of Preferred Stock and any such shares may be reissued as shares of the Series B Preferred Stock or of any other series.

(v) In case securities other than Common Stock, cash or property shall be issuable, payable or deliverable by the Corporation upon conversion as aforesaid, then all reference in this paragraph (f) shall be deemed to apply, so far as appropriate and as nearly as may be, to such other securities, cash or property.

(C) The date of adoption of said resolution by the Board of Directors was June 20, 1968, and the manner of adoption was by majority vote of the Corporation's Board of Directors at a meeting duly convened at which a quorum was present and acting throughout pursuant to the authority conferred by the Corporation's Articles of Incorporation as amended.

IN TESTIMONY WHEREOF, witness the signature of National Industries, Inc. by its officers, Stanley R. Yarmuth, President, and Gerald H. Weinstein, Secretary, this 20th day of June, 1968.

NATIONAL INDUSTRIES, INC.

STANLEY R. YARMUTH
President

GERALD H. WEINSTEIN
Secretary

STATE OF KENTUCKY
COUNTY OF JEFFERSON ss.:

I, a Notary Public, within and for the State and County aforesaid, certify that on this day the foregoing instrument of writing was produced before me by Stanley R. Yarmuth and Gerald H. Weinstein, personally known to me, who are President and Secretary respectively, of National Industries, Inc., a Kentucky corporation, a party thereto, and each of them acknowledged and delivered said instrument of writing to be the act and deed of said corporation and to be the act and deed of each of them as President and Secretary aforesaid.

My notarial commission will expire 12-4-71.

In Testimony Whereof, witness my signature and Notarial Seal hereto affixed at Louisville, Kentucky, this 20th day of June, 1968.

ALICE C. ROSSELL
Notary Public, Kentucky

(Notarial Seal)

APPENDIX 3

Warrant
to Purchase
.... shares

No.

VOID AFTER OCTOBER 31, 1978

WARRANT TO PURCHASE COMMON STOCK OF
NATIONAL INDUSTRIES, INC.

EXERCISABLE ONLY ON OR AFTER OCTOBER 31, 1968

This Certifies that for value received or registered assigns is entitled to purchase from NATIONAL INDUSTRIES, INC., a corporation incorporated under the laws of the Commonwealth of Kentucky (the "Company"), fully paid and non-assessable shares of Common Stock, par value $1.00 per share, of the Company ("Common Stock"), upon presentation and surrender of this Warrant, duly countersigned by the Agent referred to and with the Subscription Form duly executed, at any time on or after November 1, 1968 and on or before October 31, 1978, at the office of Franklin National Bank, 130 Pearl Street, New York, New York (the "Agent") and upon payment therefor of the purchase price, in lawful money of the United States of America, of $21.40 per share, subject to adjustment as herein provided.

This Warrant will not be valid and may not be transferred or exercised unless countersigned by the Agent.

In certain contingencies provided for upon the back of this Warrant (to which reference is hereby made), the number of shares of Common Stock subject to purchase hereunder and/or the purchase price thereof are subject to adjustment, but the shares of Common Stock of the Company subject to purchase hereunder are the shares of such stock of the Company as they may exist on the date of the exercise of this Warrant, whether or not the rights or interests represented by such shares are equivalent to the rights or interests represented by the shares of Common Stock of the Company authorized at the date hereof.

This Warrant may be divided and is transferable at the corporate trust office of Franklin National Bank, 130 Pearl Street, New York, New York, by the registered holder hereof or by his attorney thereunto duly authorized upon surrender of this Warrant duly endorsed. If the right to subscribe to less than all of the shares covered hereby shall be so transferred, the registered holder hereof shall be entitled to receive a new Warrant or Warrants covering in the aggregate the number of shares with respect to which the right to subscribe shall not have been so transferred, and the transferee or transferees shall be entitled to receive a new Warrant or Warrants covering in the aggregate the remaining number of shares.

Prior to the exercise of this Warrant, this Warrant shall not entitle the holder to any rights of a stockholder of the Company, including without limitation the right to vote, to receive dividends or other distributions or to exercise any pre-emptive rights, and shall not entitle the holder to receive any notice of any proceedings of the Company except as provided on the back of this Warrant.

The Company and the Agent may deem and treat the registered holder hereof as the absolute owner of this Warrant (notwithstanding any notations of ownership or writing hereon made by anyone other than the Company or the Agent) for all purposes and shall not be affected by any notice to the contrary.

THIS WARRANT SHALL BE WHOLLY VOID AND OF NO EFFECT AFTER OCTOBER 31, 1978.

WITNESS the facsimile seal of the Company and the facsimile signature of a duly authorized officer of the Company.

Dated as of December .., 1969

NATIONAL INDUSTRIES, INC.

Countersigned:

By .....
[Title]

By .....Agent
Authorized Officer

Dated:

[Reverse Side]

STATEMENT OF OTHER TERMS OF THE WARRANT, INCLUDING PROVISIONS RELATING TO ADJUSTMENT OF THE PURCHASE PRICE PAYABLE FOR EACH SHARE OF COMMON STOCK AND ADJUSTMENT OF THE NUMBER OF SHARES PURCHASABLE:

1. The term "Expiration Date" shall mean the close of business on October 31, 1978, or if said date shall in the State of New York be a holiday or a day on which banks are authorized to close, then the next following date which in the State of New York is not a holiday or a day on which banks are authorized to close.

2. The purchase price for each share of Common Stock purchasable pursuant to the exercise of the Warrants (hereinafter referred to as the "Purchase Price") shall be $21.40 per share in funds of the United States of America (subject to adjustment as provided in Paragraph 3 below).

3. The Purchase Price and the number of shares purchasable shall be adjusted from time to time as follows:

(a) In case the Company shall, while any of the Warrants are outstanding, (i) pay a dividend in shares of its Common Stock, (ii) subdivide its outstanding shares of Common Stock, (iii) combine its outstanding shares of Common Stock into a smaller number of shares, or (iv) issue by reclassification of its Common Stock any shares of stock of the Company, the number of shares of Common Stock or other securities purchasable upon the exercise of each Warrant then outstanding shall be the number of shares of Common Stock or other securities of the Company which the holder would have owned or would have been entitled to receive after the happening of any of the events described above, had such Warrant been exercised immediately prior to the happening of such event. An adjustment made pursuant to this Subparagraph (a) shall become effective immediately after the opening of business on the day next following (x) the record day of such dividend or (y) the day upon which such subdivision, combination or reclassification shall become effective.

(b) In case the Company shall, while any of the Warrants are outstanding, issue rights or warrants to all holders of its Common Stock entitling them, for a period expiring within 45 days after the record date for the determination of shareholders entitled to receive such rights or warrants, to subscribe for or purchase shares of Common Stock at a price per share less than the current market price per share of Common Stock (as defined in Subparagraph (e) below) on such record date, the number of shares of Common Stock purchasable upon the exercise of each Warrant then outstanding shall be determined by multiplying the number of shares of Common Stock to which the holder thereof was theretofore entitled to receive, upon the exercise thereof, by a fraction, of which the numerator shall be the number of shares of Common Stock outstanding on the date of issuance of such rights or warrants plus the number of additional shares of Common Stock offered for subscription or purchase, and of which the denominator shall be the number of shares of Common Stock outstanding on the date of issuance of such rights or warrants plus the number of shares which the aggregate offering price of the total number of shares so offered would purchase at such current market price. Such adjustment shall be made whenever such rights or warrants are issued and shall become effective retroactively immediately after the record date for the determination of stockholders entitled to receive such rights or warrants.

(c) In case the Company shall, while any of the Warrants are outstanding, distribute to all holders of its Common Stock any assets or evidences of indebtedness of the Company (other than any dividend in cash payable out of consolidated earnings or earned surplus, or distributions within Subparagraphs (a) or (b) hereof) of a value per share in excess of 5% of the current market price per share of the Common Stock (as defined in Subparagraph (e) below) in any consecutive 12-month period, or rights to subscribe to its debt securities or equity securities other than Common Stock, then in each such case the number of shares of Common Stock purchasable upon the exercise of such Warrant after the record date for such distribution shall be

determined by multiplying the number of shares of Common Stock which the holder thereof was theretofore entitled to receive, upon the exercise hereof, by a fraction, of which the numerator shall be the current market price per share of the Common Stock (as defined in Subparagraph (e) below) on the record date for such distribution, and of which the denominator shall be such current market price per share of the Common Stock at such record date, less the fair value of the portion of the assets or evidences of indebtedness or subscription rights so distributed applicable to one share of Common Stock. Value shall be determined by the Board of Directors of the Company whose determination shall be conclusive and shall be described in a statement filed with the Transfer Agent or Transfer Agents for the Warrants and for its Common Stock. For the purposes of this Subparagraph (c) consolidated earnings or earned surplus shall be computed by adding thereto all charges against earned surplus on account of dividends paid in shares of Common Stock in respect of which the purchase price has theretofore been adjusted, all as determined by the independent public accountants then regularly auditing the accounts of the Company, whose determination shall be conclusive.

(d) In the event of any adjustment of the total number of shares of Common Stock or other securities purchasable upon the exercise of the then outstanding Warrants, the Purchase Price per share shall be adjusted to be the amount resulting from dividing the number of shares (including fractional share interests) covered by such Warrants immediately after such adjustment into the total amount payable upon exercise of said Warrants in full.

(e) For the purpose of any computation under Subparagraphs (b) and (c) above, the current market price per share of the Common Stock at any date shall be deemed to be the average of the daily closing prices for the twenty consecutive business days commencing thirty-five business days before such record date. The closing price for each day shall be the last reported sales price regular way or, in case no such reported sale takes place on such day, the average of the reported closing bid and asked prices regular way, in either case on the New York Stock Exchange or the American Stock Exchange or, if the Common Stock is not listed on either Exchange, the average of the closing bid and asked prices as furnished by any member of the New York Stock Exchange selected from time to time by the Corporation for the purpose. The term "business day" as used in this Subparagraph (e) means any day on which such Exchange shall be open for trading.

(f) No adjustment in the Purchase Price or the number of shares purchasable shall be made by reason of the issuance, in exchange for cash, property or services, of shares of Common Stock or any securities convertible into or exchangeable for shares of Common Stock or carrying the right to purchase any of the foregoing.

(g) No adjustment in the Purchase Price or the number of shares purchasable shall be required unless such adjustment would require an increase or decrease of at least $.50 in such price; provided, however, that any adjustments which by reason of this Subparagraph (g) are not required to be made shall be carried forward and taken into account in any subsequent adjustment.

(h) For all purposes of this Warrant, the term "Common Stock" shall mean (i) the class of stock designated as the common stock of the Company at the date of this Warrant, or (ii) any other class of stock resulting from successive changes or reclassifications of such common stock. In the event that at any time as a result of an adjustment made pursuant to Subparagraph (a) above, the holder of each Warrant shall become entitled to receive, upon the exercise thereof, any shares of the Company other than shares of its common stock as described in Clause (i) above, thereafter the number of such other shares so receivable upon the exercise thereof shall be subject to adjustment from time to time in a manner and on terms as nearly equivalent as practicable to the provisions with respect to the Common Stock contained in Subparagraphs (a) to (g), inclusive and the provisions of each Warrant with respect to the shares of Common Stock shall apply on like terms to any such other shares.

4. Whenever the Purchase Price is adjusted as provided in Paragraph 3 above, the Company will promptly file with the Agent a certificate of a firm of independent public accountants of recognized standing selected by the Board of Directors (who may be the regular auditors of the Company) setting forth the Purchase Price as so adjusted, describing the corresponding adjustment in number of shares purchasable, stating that such adjusted Purchase Price conforms to the requirements of Paragraph 3, and setting forth a brief statement of the facts accounting for such adjustment. Such certificate shall be conclusive evidence of the correctness of such adjustment. Promptly after receipt of such certificate, the Agent will mail a brief summary thereof to the registered holders of the Warrants at their last addresses as they appear on the registry books of the Company.

5. If, prior to the Expiration Date, the Company shall consolidate with or merge into another corporation (except for a merger or consolidation in which the Company is the continuing corporation), or in case the Company shall sell or convey to any other person or persons all or substantially all of the property of the Company, the holder of each Warrant then outstanding will thereafter be entitled to receive, upon the exercise thereof, the kind and amount of shares of stock, other securities, cash and property which he would have owned or been entitled to receive after such consolidation merger, sale or conveyance had such Warrant been exercised immediately prior to the happening of such event. The Company shall take such steps in connection with such consolidation or merger as may be necessary to assure that the provisions of each such Warrant shall thereafter be applicable as nearly as reasonably may be, in relation to any securities or property thereafter deliverable upon the exercise of each such Warrant.

6. The Company shall not issue fractions of shares of Common Stock upon exercise of the Warrants but shall in lieu thereof (a) make a payment in cash based on the Purchase Price in effect at that time or (b) issue scrip certificates, in form approved by the Board of Directors, evidencing such fractional interests, which certificates, when presented with other like certificates representing in the aggregate at least one whole share, may be exchanged, without payment, for whole shares of Common Stock of the Company in accordance with the terms of such scrip certificates. Such scrip certificates may become void and of no effect after a reasonable period determined by the Board of Directors and specified therein. For the purposes of this Paragraph 6, the computation of any fractional interest in a share of Common Stock shall be made to the first two decimal places, without rounding.

7. Prior to the Expiration Date, the Company will reserve and keep available a sufficient number of shares of Common Stock to satisfy the requirements of all outstanding Warrants. The Company will take all such action as may be necessary to insure that all shares of capital stock issued upon exercise of the Warrants will be duly and validly authorized and issued and fully paid and non-assessable.

8. The Company shall not be obligated to sell any shares of Common Stock or other securities upon exercise of the Warrants if, at the time of such exercise, such sale would violate any applicable laws or governmental rules or regulations regarding sales of securities.

9. This Warrant shall be binding upon any successors or assigns of the Company.

SUBSCRIPTION FORM

To Be Executed By The Holder If He Decides to Exercise The Warrant

To: NATIONAL INDUSTRIES, INC.

The undersigned hereby irrevocably elects to exercise the right of purchase represented by the within Warrant for, and to purchase thereunder, shares of the stock provided for therein and tenders payment herewith to the order of NATIONAL INDUSTRIES, INC. in the amount of $ in accordance with the terms of the within Warrant. The undersigned requests that certificates for such shares be issued in the name of

(Please insert Social Security or other identifying number of Subscriber.)

Name

Address

and to be delivered to Name

at Address

and, if said number of shares shall not be all the shares purchasable thereunder, that a new Warrant for the balance remaining of the shares purchasable under the within Warrant be registered in the name of, and delivered to, the undersigned at the address stated below.

Address:

Dated: , 19 .

Signature .....

Note: The above signature must correspond with the name as written upon the face of this Warrant in every particular, without alteration or enlargement or any change whatever.

EXHIBIT C

PLAN OF COMPLETE LIQUIDATION
OF
TSC INDUSTRIES, INC.

The Plan of Complete Liquidation (the "Plan") is intended to carry out the complete liquidation and dissolution of TSC INDUSTRIES, INC., a Delaware corporation (the "Company"), and is as follows:

1. The Board of Directors of the Company shall adopt a resolution deeming it advisable, in the judgment of the Board of Directors, that the Company be completely liquidated and dissolved.

2. The Board of Directors shall approve the Plan and shall recommend the adoption of the Plan by the stockholders of the Company at a special meeting of the stockholders called for that purpose.

3. The Plan shall be deemed adopted upon the approval thereof at a special meeting of stockholders by the affirmative vote of the holders of record of a majority of the outstanding stock of the Company.

4. Subject to the authorization and approval, by the affirmative vote of the holders of a majority of the outstanding stock of the Company at a special meeting of stockholders called for that purpose, of the Agreement, dated as of October 16, 1969, between the Company and National Industries, Inc., a Kentucky corporation ("National"), and the transactions provided for in the Agreement, the Company shall, after the Plan shall become effective, sell its assets, properties and business, subject to substantially all of its liabilities, obligations and commitments, to a wholly-owned subsidiary of National ("Transferee") organized for that purpose in consideration of (i) the issuance by National of the National securities as provided in Section 2(a)(i) and (ii) of the Agreement and (ii) certain undertakings by National and Transferee, all pursuant to and upon the terms and conditions set forth in the Agreement (the date of such sale is herein called the "Closing Date").

5. Subsequent to the Closing Date, and prior to November 30, 1970, the Company shall pay and discharge, or otherwise satisfy or provide for the satisfaction of, all of the Company's liabilities, obligations and commitments not assumed or agreed to be performed or discharged by Transferee or National pursuant to the Agreement.

6. Subsequent to the Closing Date, and in any event prior to November 30, 1970, the Company shall distribute or cause to be distributed to its stockholders, as provided in its Certificate of Incorporation as amended prior to the Closing Date, all of the assets and property of the Company of every kind and nature whatsoever (including the National securities issued and delivered to the Company on the Closing Date), except sufficient cash required to satisfy the liabilities, obligations and commitments of the Company not transferred to or assumed by National or Transferee under the terms and provisions of the Agreement, all in complete redemption and cancellation of all of the outstanding stock of the Company and in complete liquidation of the Company. To effectuate the distribution of assets of the Company as aforesaid, the stockholders appoint The First National Bank of Chicago as Exchange Agent and trustee for the stockholders (herein called the "Trustee"), and the Company shall promptly deposit the National securities with the Trustee to be held for the account of the stockholders of the Company, pursuant to an Agreement to be entered into among the Company, National and the Trustee. Such Agreement shall provide, among other things, as follows:

(a) Upon surrender to the Trustee of certificates representing shares of $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1 of the Company ("Series 1 Preferred Stock") by the holder thereof, the Trustee shall forthwith deliver to such stockholder the National securities to which such stockholder is entitled pursuant to the terms and provisions of the Certificate of Incorporation of the Company, as amended.

(b) Upon surrender to the Trustee of certificates representing shares of Common Stock of the Company by the holder thereof, the Trustee shall forthwith deliver to such stockholder the securities to which such stockholder is entitled pursuant to the terms and provisions of the Certificate of Incorporation of the Company, as amended.

(c) Neither fractional shares of National's $1.25 Series B Cumulative Convertible Preferred Stock ("National Series B Preferred Stock") nor fractional interests in a National Warrant will be issued. Any stockholder who would be entitled to a fractional interest in a share of National Series B Preferred Stock or in a National Warrant will be given an opportunity to instruct the Trustee, within a period of 60 days following the Closing Date, either

(i) to purchase for his account, to the extent available, a sufficient additional fraction of a share or fraction of a warrant to entitle him to receive a full share or warrant, as the case may be; or

(ii) to sell any such fractional share or fractional interest in a warrant for his account and to deliver the proceeds of such sale to him.

If any stockholder, upon surrender of his Company's stock certificates, fails to give appropriate instructions, his fractional interests will be sold for his account. All fractional interests of stockholders who have not surrendered their stock certificates within such 60 day period will be aggregated and sold for the respective accounts of said stockholders.

(d) Any National securities deposited with the Trustee remaining unclaimed in the hands of the Trustee on the sixth anniversary of the Closing Date as defined in Section 9 of the Agreement will be turned over by the Trustee to National to be held for the account and benefit of the Company's stockholders entitled thereto subject to any applicable escheat, abandoned property, or similar laws.

(e) Notwithstanding anything contained in this paragraph 6 to the contrary, the Trustee will not distribute in liquidation the National securities to the former shareholders of SAS, Inc. in exchange for 40,000 shares of Series 1 Preferred Stock if such shares are issued to said former SAS, Inc. stockholders by the Company on or prior to the Closing Date, until six months from the Closing Date or 365 days from the TSC's stockholders meeting at which this Plan is adopted, whichever first occurs.

(f) All costs in connection with the receipt and distribution of the National securities and the handling of fractional interests, including all transfer taxes (other than on transfers from one stockholder to another) and the fees and expenses of the Trustee will be paid by the Company.

7. Subsequent to the transfer of the National securities to the Trustee as provided in paragraph 6 above, the Company shall be dissolved and for that purpose shall cause a Certificate of Dissolution to be executed, acknowledged and filed in the Office of the Secretary of State of Delaware pursuant to Section 275 of the General Corporation Law of Delaware; shall take such other action as may be necessary for its dissolution; and shall withdraw its authority to do business as a foreign corporation in each state in which it now has authority.

8. The officers and directors of the Company shall do and perform all acts, execute all documents, file all reports, statements, certificates and returns, take all action and enter into all transactions in the name and on behalf of the Company both before and after the dissolution of the Company which they shall deem necessary or desirable to perform the Company's undertakings in the Agreement, to wind up the business and affairs of the Company, and to complete the distribution of all of the Company's assets to the stockholders of the Company in complete liquidation of the Company subject, however, to the provisions of this Plan.

9. This Plan shall become effective on the date of its adoption and approval by the affirmative vote of the holders of a majority of the outstanding stock of the Company given at a special meeting of the stockholders duly called for such purpose and shall have no force and effect before such date.

10. It is intended that the Plan shall be a Plan of Complete Liquidation within the terms of Section 337 of the Internal Revenue Code of 1954. The Plan shall be deemed to authorize such further action as, in the opinion of counsel for the Company, may be necessary to conform with the provisions of such Section 337.

11. The Plan shall terminate and be of no further force or effect whatsoever if on or before June 30, 1970 the Company, for any reason, shall not have sold its assets, properties and business subject to substantially all its liabilities, obligations and commitments to National pursuant to the terms of the Agreement.

EXHIBIT D

CERTIFICATE OF AMENDMENT OF
CERTIFICATE OF INCORPORATION
OF
TSC INDUSTRIES, INC.

TSC INDUSTRIES, INC., a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware, DOES HEREBY CERTIFY:

FIRST: That at a meeting of the Board of Directors of said corporation duly convened and held on October 16, 1969, resolutions were adopted setting forth proposed Amendments to the Certificate of Incorporation of said corporation, declaring said Amendments to be advisable and directing that the proposed Amendments be considered at a Special Meeting of Stockholders. The resolutions setting forth the proposed Amendments are as follows:

1. AMENDMENT TO ARTICLE FIRST

"RESOLVED, that this Board of Directors does hereby adopt and declare advisable an Amendment to Article First of the Certificate of Incorporation of the corporation so that said Article First, as amended, shall read as follows:

"*First.* The name of the corporation is TS Liquidating Company.

II. AMENDMENT TO ARTICLE FOURTH, PART 2, SECTION 2.5

"FURTHER RESOLVED, that this Board of Directors does hereby adopt and declare advisable an Amendment to Article Fourth, Part 2, Section 2.5 of the Certificate of Incorporation of the corporation so that the said Article Fourth, Part 2, Section 2.5, as amended, shall read as follows:

"2.5 *Liquidation rights*

"2.51 In the event of any voluntary liquidation, dissolution or winding-up of the corporation, pursuant to any plan of complete liquidation adopted by the Board of Directors on or before December 1, 1969, before any distribution shall be made to the holders of common stock or any stock junior to the preferred stock as to liquidation, the holders of each share of preferred stock of each series shall be entitled to receive a preferential liquidating distribution consisting of certain securities of National Industries, Inc., a Kentucky corporation ("the National Securities") to wit: .6 share of $1.25 Series B Cumulative Convertible Preferred Stock ("National Preferred Stock"), and a warrant entitling the holders thereof to purchase one share of common stock of said National Industries, Inc., at a price of $21.40 per share at any time on or before October 31, 1978 ("National Warrant"). The holders of preferred stock shall not be entitled to receive any fractional interest in the National Securities upon liquidation. In lieu thereof, the holders of preferred stock shall have the right, exercisable any time prior to 60 days after the date on which the National Securities are issued to the corporation, to purchase an additional fractional interest required for a full share of National Preferred Stock or a full National Warrant at the prevailing market price for National Preferred Stock on the New York Stock Exchange and for the National Warrant on the American Stock Exchange. In the event any preferred stockholder fails to elect to purchase an additional fractional interest within the aforementioned 60 day period, said stockholder shall be entitled to receive a cash payment (payable by check) equal to the price at which said fractional interest is sold on the New York Stock Exchange or the Ameri-

can Stock Exchange as the case may be. The holders of preferred stock, upon liquidation, shall be entitled to receive the above-mentioned preferential liquidating distribution and no more, and shall not be entitled to participate in any further liquidating distributions.

"2.52 In the event of any involuntary liquidation, dissolution or winding up of the corporation occurring at any time, or any voluntary liquidation, dissolution or winding up (other than a liquidation, dissolution or winding up referred to in Section 2.51 above), and subject to the provisions of Part 4 hereof fixing the liquidation rights of holders of series 1 preferred stock and to the provisions of the resolutions of the board of directors providing for the issue of any other series of preferred stock that stock of such series shall rank on a parity with the series 1 preferred stock upon liquidation, the holders of preferred stock of each series shall be entitled to receive the full preferential amount, if any, fixed by the certificate of incorporation or by the resolutions of the board of directors providing for the issue of such series, including any arrearages in dividends thereon to the date fixed for the payment in liquidation, before any distribution shall be made to the holders of common stock or any stock junior to the preferred stock as to liquidation. After payment in full of such preferential amounts to the holders of the preferred stock of the respective series entitled thereto, the remaining assets of the corporation shall then be distributable exclusively among the holders of the series 1 preferred stock and preferred stock of any series ranking on a parity with series 1 preferred stock upon liquidation and the holders of common stock and any stock junior to the preferred stock outstanding as to liquidation, according to their respective interests.

"2.53 If the assets of the corporation are insufficient to permit the payment of the full preferential amounts payable to the holders of the preferred stock of the respective series in the event of a liquidation, dissolution or winding-up, then the assets available for distribution to holders of the preferred stock of the respective series entitled to such preferential amounts shall be distributed ratably to such holders in proportion to the full preferential amounts payable on their respective shares upon liquidation.

"2.54 A consolidation or merger of the corporation with or into one or more corporations or a sale, lease or exchange of all or substantially all of the assets of the corporation shall not be deemed to be a liquidation, dissolution or winding-up, voluntary or involuntary, within the meaning of this section 2.5.

III. AMENDMENT TO ARTICLE FOURTH, PART 4, SECTION 4.3

"FURTHER RESOLVED, that this Board of Directors does hereby adopt and declare advisable an amendment to Article Fourth, Part 4, Section 4.3 of the Certificate of Incorporation of the corporation so that said Article Fourth, Part 4, Section 4.3, as amended, shall read as follows:

"4.3 Liquidation rights

"4.31 In the event of any voluntary liquidation, dissolution or winding-up of the corporation, pursuant to any plan of complete liquidation adopted by the Board of Directors on or before December 1, 1969, before any distribution shall be made to the holders of common stock or any stock junior to the series 1 preferred stock as to liquidation, the holders of each share of series 1 preferred stock shall be entitled to receive a preferential liquidating distribution consisting of certain securities of National Industries, Inc., a Kentucky corporation ("the National Securities"), to wit: .6 share of $1.25 Series B Cumulative Convertible Preferred Stock ("National Preferred Stock") and a warrant entitling the holders thereof to purchase one share of common stock of said National Industries, Inc., at a price of $21.40 per share at any time on or before October 31, 1978 ("National Warrant"). The holders of series 1 preferred stock shall not be entitled to receive any fractional interest in the National Securities upon liquidation. In lieu thereof, each holder of series 1 preferred stock shall have the right, exercisable any time prior to 60 days after

the date on which the National Securities are issued to the corporation, to purchase an additional fractional interest required for a full share of National Preferred Stock or a full National Warrant at the prevailing market price for National Preferred Stock on the New York Stock Exchange and for the National Warrant on the American Stock Exchange. In the event any series 1 preferred stockholder fails to elect to purchase an additional fractional interest within the aforementioned 60 day period, said stockholder shall be entitled to receive a cash payment (payable by check) equal to the price at which said fractional interest is sold on the New York Stock Exchange or the American Stock Exchange as the case may be. The holders of series 1 preferred stock, upon liquidation, shall be entitled to receive the above mentioned preferential liquidating distribution and no more, and shall not be entitled to participate in any further liquidating distributions.

"4.32 In the event of any involuntary liquidation, dissolution or winding-up of the corporation occurring at any time, any voluntary liquidation, dissolution or winding up (other than a liquidation, dissolution or winding up referred to in Section 4.31 above), (a) the holders of the series 1 preferred stock shall be entitled to receive an amount equal to all the arrearages in dividends thereon to the date fixed for the payment in liquidation, before any distribution shall be made to the holders of stock junior to the preferred stock, and (b) the holders of the series 1 preferred stock, the holders of any other series of preferred stock ranking on a parity with the series 1 preferred stock upon liquidation as provided by the resolutions of the board of directors providing for the issue of such series and the holders of the common stock shall be entitled to share ratably in assets of the corporation available for distribution to them, subject to the condition that for this purpose the shares of series 1 preferred stock then outstanding shall be deemed to be the equivalent of the number of shares of common stock of the corporation (calculated to the nearest 1/100 of a share) into which they are by their terms convertible at the date fixed for payment in liquidation at the conversion rate in effect at that time and the ratio in which the shares of such other series shall share in such assets shall be determined in accordance with the resolutions of the board of directors providing for the issue of such series.

IV. AMENDMENT TO ARTICLE FOURTH, PART 4, SECTION 4.51

"FURTHER RESOLVED, that this Board of Directors does hereby adopt and declare advisable an amendment to Article Fourth, Part 4, Section 4.51 of the Certificate of Incorporation of the Corporation so that said Article Fourth, Part 4, Section 4.51 as amended, shall read as follows:

"4.51 Subject to and upon compliance with the provisions of this Section 4.5, the holder of any shares of series 1 preferred stock shall have the right at his option to convert all or any of such shares into fully paid and non-assessable shares of common stock of the corporation (calculated to the nearest 1/100 of a share) at the conversion rate of 0.75 share of common stock for each share of series 1 preferred stock, or in case an adjustment or adjustments in the conversion rate shall have taken place pursuant to provisions of subsection 4.55, then at the applicable conversion rate as so adjusted, provided, however, that such right of conversion shall terminate, (i) with respect to any shares called for redemption, at the close of business on the date fixed for redemption, unless the corporation shall default in the payment due upon redemption thereof, or, (ii) as of the close of business on the last regular business day prior to the date of consummation of any transaction whereby the corporation shall cease doing business as a separate entity either as a result of merger, consolidation, or sale, lease, or exchange of all or substantially all of its assets. Notwithstanding the foregoing, if the last day for the exercise of the conversion right shall be, in any city in which the conversion agency is then maintained, a day on which banking institutions are authorized by law to close, then such conversion right may be exercised on the next succeeding day not a day on which banking institutions in such city are so authorized by law

to close. No adjustment shall be made for dividends accumulated on any shares of series 1 preferred stock so converted nor for dividends on any common stock of the corporation that shall be issuable on any such conversion."

SECOND: That thereafter, pursuant to the resolutions of the Board of Directors, the proposed Amendments were submitted for consideration at a Special Meeting of Stockholders of the corporation duly called and held on December .., 1969, at which meeting the stockholders holding the necessary number of shares of stock required by statute and by the Certificate of Incorporation and the By-Laws of said corporation, voted in favor of said Amendments, namely, (i) more than a majority of the outstanding shares of common stock and series 1 preferred stock on the amendment to Article First of the Certificate of Incorporation, and (ii) more than a majority of the outstanding common stock and more than 66⅔% of the series 1 preferred stock, each such class of stock voting separately as a class, on the amendments to Article Fourth of the Certificate of Incorporation. The common stock and series 1 preferred stock are the only classes of stock of the corporation outstanding.

THIRD: That said Amendments were duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware and the Certificate of Incorporation and By-Laws of said corporation.

FOURTH: That the capital of the corporation will not be reduced under or by reason of the Amendments.

IN WITNESS WHEREOF, said TSC INDUSTRIES, INC., has caused its corporate seal to be hereunto affixed and this Certificate to be signed by RICHARD H. SCHAEFER, its President and LAWRENCE W. SCHWEIK, its Secretary, this .... day of December, 1969.

TSC INDUSTRIES, INC.

By .....
President

ATTEST:

.....
Secretary

STATE OF ILLINOIS
COUNTY OF COOK } ss.

BE IT REMEMBERED, that on this .... day of December, A.D. 1969, personally came before me....., a notary public in and for the County and State aforesaid, RICHARD H. SCHAEFER and LAWRENCE W. SCHWEIK, the President and Secretary respectively, of TSC INDUSTRIES, INC., a corporation of the State of Delaware, known to me personally to be such, and acknowledged the within instrument to be their act and deed and the act and deed of said corporaton, that the facts stated therein are true, and that the seal affixed to the said instrument is the corporate seal of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and seal the day and year first above wrtten.

.....
Notary Public

EXHIBIT B TO COMPLAINT.

Stock Purchase Agreement between National Industries, Inc. and Schmidt Defendants, February 7, 1969.

STOCK PURCHASE AGREEMENT

AGREEMENT, dated as of the 30th day of January, 1969, by and between NATIONAL INDUSTRIES, INC., a Kentucky corporation, having an office at 510 West Broadway, Louisville, Kentucky 40202 (hereinafter called "NATIONAL"), and each of the Sellers listed on the signature page hereof (hereinafter collectively called "SELLERS").

WITNESSETH:

THAT, in consideration of the mutual covenants and obligations herein contained, it is agreed as follows:

1. Each of the Sellers, respectively, agrees to sell to National, and National agrees to purchase from Sellers, subject to the terms and conditions hereof, that number of shares of $.70 Cumulative Convertible Preferred Stock, par value $1.00 per share, at a price of $22.50 per share and that number of shares of Common Stock, par value $1.00 per share, at a price of $30.00 per share of TSC INDUSTRIES, INC., a Delaware corporation (hereinafter called "TSC"), set forth opposite each such Seller's name as follows:

	No. of Shares of TSC Sold	
SELLERS:	Common Shares	$.70 Cum. Preferred
Charles E. Schmidt	411,703*	338,974
Dorothy F. Schmidt	5,297	30,000
Richard L. Schmidt	6,000	30,001
Charles E. Schmidt, Jr.	1,000	40,600
Charles E. and Dorothy F. Schmidt Family Foundation	3,840	–
Total	427,840*	439,575

* If Charles E. Schmidt obtains any of the shares referred to below as held by the Trustees of the Tractor Supply Company's Stock Bonus Trust and delivers such shares to National prior to March 7, 1967, National will buy such shares on the terms set forth herein. No additional warrants shall be issued.

Each Seller, respectively, represents that, to the best of such Seller's knowledge, the number of shares of TSC set forth above opposite his name are all of the shares of TSC owned by such Seller, directly or indirectly, except that Charles E. Schmidt is entitled to receive not more than 12,000 additional shares of TSC Common Stock presently held by the Trustees of the Tractor Supply Company's Stock Bonus Trust.

2. The total consideration payable to each Seller hereunder shall be paid as follows:

(a) By delivery to each Seller at the closing, by certified or cashier's check, of an amount equal to 25% of the aggregate price due such Seller hereunder; and

(b) By delivery to each Seller at closing of National's promissory note in the form of Exhibit A attached hereto, evidencing the balance of the purchase price due each Seller, respectively, and payable in five annual installments of principal, commencing one year after the closing, each in an amount equal to 10% of the total price due to each Seller for his stock, with a sixth and final installment of the balance of the purchase price due one year after the last of such 10% installments, and with interest from the closing date to the date of payment at the rate of 5% per annum as provided in said Exhibit A;

(c) By delivery to each Seller at closing of Common Stock purchase warrants in the form of Exhibit B attached hereto granting to each of the Sellers the right to purchase that number of shares of Common Stock of National at a price of $24.00 per share that shall bear the same proportion to 125,000 as the aggregate consideration to be paid to each such Seller hereunder in cash and notes shall bear to the total consideration to be paid to all Sellers hereunder in cash and notes.

3. At the closing as hereinafter set forth, all of the following shall be done, namely:

(a) Each Seller shall deliver to National certificates for his shares of TSC being sold hereunder, duly endorsed in blank, with signature duly guaranteed, and with all necessary documentary stamps affixed thereto and cancelled, and where required with appropriate corporate resolutions attached;

(b) National shall deliver to each Seller a certified or cashier's check, its promissory note dated the date of closing and payable to the order of each such Seller, and its Common Stock purchase warrants, all as provided in paragraph 2 above.

(c) Each Seller shall deliver to National a proxy in the form of Exhibit C attached hereto.

(d) Each Seller shall deliver to National separate investment letters wherein each such Seller represents and warrants that (i) he is acquiring the promissory note payable to him, is acquiring the warrant delivered to him, and will acquire any of the shares of Common Stock issued to him upon exercise of the warrant delivered to him, for investment and not with a view to or for sale or other distribution thereof and (ii) he will not publicly offer or sell the promissory note and/or warrant acquired hereunder or the shares of Common Stock issuable on exercise of the warrant, in violation of the Securities Act of 1933, as amended.

(e) National shall deliver to Sellers the Certificate of its Secretary or Assistant Secretary duly certifying resolutions adopted by National's Board of Directors or Executive Committee authorizing the execution and delivery of this Agreement and the consummation of the transaction herein contemplated including issuance of the National stock on exercise of the warrants referred to in paragraph 2(c) hereof.

(f) Each of the Sellers shall receive an opinion of Friedman, Koven, Shapiro, Salzman, Koenigsberg, Specks

& Homer that (i) the transaction contemplated hereby has been duly authorized by all proper corporate action of National, (ii) that each of the notes delivered by National at the closing has been duly authorized by and executed on behalf of National and is a valid and binding obligation of National in accordance with its terms, (iii) that each of the warrants delivered by National at the closing has been duly authorized and executed by or on behalf of National and is a valid and binding agreement of National in accordance with its terms and (iv) that the shares of Common Stock of National initially issuable on exercise of such warrants have been duly authorized for issuance. In giving such opinion such counsel may rely upon certificates of officers of National or opinions of Kentucky counsel satisfactory to such counsel. A copy of any opinion relied upon by Friedman, Koven, Shapiro, Salzman, Koenigsberg, Specks & Homer shall be attached to their opinion.

4. The closing hereunder, at which the transactions hereinabove specified shall be consummated, shall be held on February 7, 1969, at 11:00 A.M. (CDT), at the offices of Friedman, Koven, Shapiro, Salzman, Koenigsberg, Specks & Homer, 208 South LaSalle Street, Chicago, Illinois, or at such other time and place as shall be mutually agreed upon in writing.

5. Each Seller represents and warrants as follows:

(a) that the shares of TSC to be sold by him or it hereunder are owned by such party, are validly issued, fully paid and non-assessable shares of TSC, and when delivered to National at the closing hereunder will be free and clear of all restrictions, liens, security interest, pledges and encumbrances of every kind and nature whatever or any rights or interests therein in favor of any other party (such as a right of first refusal agreement or buy-sell agreement), and that each Seller has and will have at the closing full right, power and authority to sell, transfer and deliver said shares as provided herein; and

(b) that he is acquiring the promissory note payable to him, the warrant delivered to him, and will acquire any of the shares of Common Stock issued to him upon exercise of the warrant, for investment and not with a view to or for sale or other distribution thereof, and he will not publicly offer or sell the promissory note and warrant acquired hereunder, or the shares of Common Stock issuable on exercise of the warrant, in violation of the registration provisions of the Securities Act of 1933, as amended (it being agreed that each promissory note and warrant deliverable hereunder and each certificate for shares of Common Stock issuable on exercise of each such warrant shall bear a legend on the face thereof to the effect that the promissory note, the warrant, or the shares of Common Stock, as the case may be, may not be transferred, assigned, hypothecated or otherwise disposed of without prior registration under the Securities Act of 1933, as amended, or an opinion of counsel selected by or acceptable to National that such registration is not required).

6. National agrees that it will not sell or transfer any of the shares of TSC purchased hereunder, in violation of the registration requirements of the Securities Act of 1933.

7. Each Seller agrees to do any and all acts and things deemed necessary or desirable by National to perfect record title in National of the shares of TSC being sold and purchased hereunder, and to afford National the benefit of all incidents of ownership of such shares, including the execution and delivery of a proxy in the form of Exhibit C attached hereto.

8. The parties, each for himself and itself represent and warrant that no broker or finder has been employed by any of them in connection with the transaction contemplated hereby, except for (i) Mr. Frank Cryan for whose fee Mr. Charles E. Schmidt shall be responsible and (ii) Henderson, O'Reilly & Co. for whose fee National shall be responsible, and that the

fees payable by the respective parties as aforesaid are only payable upon consummation of the transaction contemplated hereunder. Each party agrees to indemnify and hold the other party harmless from any damages or expenses, including attorneys' fees, which either party may suffer as a result of any claim of a broker or finder with whom it is finally determined that the other party has dealt with in contravention of the above representation.

9. National represents that the financial statements of National contained in its Prospectus dated October 3, 1968 were accurate and complete in all material respects on the basis stated therein as of the respective dates of such financial statements.

10. In the event that any Seller fails to deliver any or all of the TSC shares set opposite his or its name in paragraph 1 above, National may, at its option, terminate this agreement without liability to the Sellers; provided that, if the Sellers shall be unable to deliver in the aggregate not more than 5,000 shares of Common Stock and not more than 5,000 shares of Cumulative Convertible Preferred Stock at the closing provided for in paragraph 4 hereof, National will accept the shares delivered and make payment therefor on the per share basis set forth herein except that the warrants issuable to any party failing to deliver the full number of shares shall be proportionately reduced. In any such event each Seller agrees to use his best efforts to have such missing shares delivered to National against payment therefor in accordance with the terms hereof as soon as possible, provided that National shall have no obligation to accept such shares if delivery is not made within thirty days of the closing provided in paragraph 4.

11. This agreement constitutes the entire agreement between the parties hereto with respect to the subject matter hereof, and supersedes any and all prior agreements or understandings of any kind, oral or written, with respect thereto.

12. This agreement may not be changed, amended, waived, discharged or terminated orally, but only by an instrument in writing subscribed by the party against whom or which enforcement of the change, amendment, waiver, discharge or termination is sought. No such waiver shall extend to or affect any obligation not expressly waived or impair any right consequent thereon.

13. This Agreement and the instruments herein referred to shall inure to the benefit of and be binding upon the respective parties and their respective heirs, executors, administrators, successors and assigns.

14. This Agreement shall be governed by and construed in accordance with the laws of the State of Illinois.

15. This Agreement may be terminated at any time by mutual written agreement of the Sellers and National. Upon any such termination of this Agreement, neither the Seller nor National shall have any liability one to the other under this Agreement and each party shall bear its own expenses except as otherwise mutually agreed upon in writing.

16. All notices which shall or may be given under this Agreement shall be in writing, shall be signed by the person giving the same, and shall be deemed sufficiently given only if sent by registered mail, postage pre-paid and return receipt requested, addressed as follows:

If to National:

Stanley R. Yarmuth, President
National Industries, Inc.
510 West Broadway
Louisville, Kentucky 40202

with a copy to

Charles N. Salzman
Friedman, Koven, Shapiro, Salzman,
Koenigsberg, Specks & Homer
208 South LaSalle Street
Chicago, Illinois 60604

If to Sellers:

c/o Charles E. Schmidt
c/o Davis Polk & Wardwell
1 Chase Manhattan Plaza
New York, New York 10005
Attn: John I. Brokaw

or such other addresses as any of the aforesaid may have furnished to the other from time to time.

17. This Agreement may be executed in any number of counterparts, each of which when executed and delivered shall be an original, but all such counterparts shall constitute one and the same instruments. If [sic] shall not be necessary in proving this Agreement to produce or account for more than one such counterpart.

IN WITNESS WHEREOF, National has caused this Agreement to be executed and delivered in its name and behalf by one of its officers thereunto duly authorized, and each Seller has hereunto set his or its hand and seal, on the day and year hereinafter set forth.

NATIONAL INDUSTRIES, INC.,
By /s/ ALLAN B. SOLOMON,
Allan B. Solomon,
Vice President.

/s/ CHARLES E. SCHMIDT,
Charles E. Schmidt,

/s/ DOROTHY F. SCHMIDT,
Dorothy F. Schmidt,

/s/ RICHARD L. SCHMIDT,
Richard L. Schmidt,

/s/ CHARLES E. SCHMIDT, JR.,
Charles E. Schmidt, Jr.,

CHARLES E. AND DOROTHY F. SCHMIDT FAMILY FOUNDATION, an Illinois Not-for Profit corporation
By /s/ CHARLES E. SCHMIDT,
President.

Attest:

/s/ DOROTHY F. SCHMIDT,
Secretary.

EXHIBIT "A".

Under the terms of an agreement dated January 30, 1969, between the maker and the payee and others, copies of which are on file at the office of the maker, National Industries, Inc., Louisville, Kentucky, this installment promissory note may not be sold, transferred, assigned, hypothecated or otherwise disposed of unless (i) a registration statement with respect thereto has been filed and has become effective under the Securities Act of 1933, as amended, or (ii) the maker has received an opinion of counsel selected by or satisfactory to it to the effect that such sale, transfer, assignment, hypothecation or other disposition may lawfully be made without registration under the said act.

INSTALLMENT PROMISSORY NOTE.

$_____ Chicago, Illinois

_____, 1969

For value received, the undersigned, NATIONAL INDUSTRIES, INC., a Kentucky corporation (the "Maker"), promises to pay to the order of _____ (the "Payee"), the principal sum of _____ Dollars ($_____) in six installments, the first in the amount of $_____ payable on _____, 1970, the second in the amount of $_____ payable on _____, 1971, the third in the amount of $_____ payable on _____, 1972, the fourth in the amount of $_____ payable on _____, 1973, the fifth in the amount of $_____ payable on _____, 1974, and the sixth in the amount of $_____ payable on _____, 1975. Interest shall be payable from the date hereof until maturity at the rate of 5% per annum on the unpaid principal balance thereof, on *_____ and on each date thereafter on which principal

'* Insert here the date which is 9 months after the Closing Date.

payments are due. Principal not paid when due, whether at stated maturity, by acceleration or otherwise, and (to the extent permitted by law) overdue interest shall bear interest from the date upon which the same became due at the rate of Seven Percent (7%) per annum, payable upon demand.

Principal and interest hereunder shall be payable, in lawful money of the United States, by depositing same at the First National City Bank, New York, New York (the "Bank") for the account of the Payee. The Payee shall be entitled to receive and be paid the monies so deposited by presenting this Note for an endorsement reflecting payment of the subject installment or installments of principal and/or interest.

This Note is one of an authorized issue of Installment Promissory Notes (the "Notes") of even date and of like tenor herewith, but of varying principal amount, in the aggregate principal sum of $....., issued by the Maker pursuant to a Stock Purchase Agreement (the "Agreement") dated ....., 1969, between the Maker and several Sellers. Each of the Notes so issued is without preference, priority or distinction in any way whatsoever over any other Notes so issued.

Subject to the provisions of the succeeding paragraphs, the Company may, at its option, at any time and from time to time after January ____, 1970, and without penalty or premium, make prepayments, in whole or in part of the unpaid principal of and accrued interest on this Note. All prepayments are to be paid first to satisfy interest accrued to date of prepayment and then against unpaid principal in the order of maturity of the indebtedness for principal.

The Company agrees that all prepayments of principal and interest upon any of the Notes of the Maker issued as aforesaid shall be made pro rata upon all outstanding Notes so issued.

If any interest or principal due and payable on this Note shall not have been paid within twenty (20) business days after notice to the Maker that such amount is due and unpaid the Payee, at his option, may declare the entire principal of and all accrued interest on this Note immediately due and payable by written notice to the Maker, whereupon the entire

principal of and all accrued interest on this Note shall immediately become due and payable.

No delay or omission on the part of any Payee in exercising any rights under the Note shall operate as a waiver of such right or any other right thereunder. A waiver on any one occasion shall not be construed as a bar to or waiver of any such right and/or remedy at any future occasion.

Except as herein otherwise expressly provided, the Maker waives diligence, presentment, demand, notice, protest, and all other demands and notices in connection with the delivery, acceptance, performance, default or enforcement of or under the Note, and assents to any extension or postponement of the time of payment, or any other indulgence under, or waiver of any provision of the Note. Nothing in this paragraph shall be construed to prevent the Maker from paying this Note on its stated maturity or to eliminate the necessity for written consents of the Maker to any amendment of the Agreement insofar as such Maker's several obligations are concerned, or of this Note.

The undersigned will pay all expenses of every kind for the enforcement of this Note, or of any of the rights hereunder and hereby agrees to pay to the Payee on demand the amount of any and all such expenses incurred by it.

As herein used, the word "Payee" shall mean the person named as "Payee" and any endorsee of this Note, who is in possession of it, or the bearer hereof, if this Note is at the time payable to the bearer.

All notices which shall or may be given to the Maker shall be in writing, shall be signed by the person giving the same, and shall be sufficiently given only if sent by registered mail, postage prepaid and return receipt requested, addressed as follows:

National Industries, Inc.
510 West Broadway
Louisville, Kentucky 40202

or at such other address as the Maker shall have designated in writing to the Holder.

NATIONAL INDUSTRIES, INC.

By _____

EXHIBIT "B"

Under the Terms of an Agreement Dated as of January 30, 1969, Between the Company and Charles E. Schmidt, *et al.*, a Copy of Which Is on File at the Office of the Company, This Warrant May Not Be Sold, Transferred or Otherwise Disposed of Until (i) a Registration Statement with Respect Thereto Has Been Filed and Has Become Effective Under the Securities Act of 1933, as Amended, or (ii) the Company Has Received an Opinion of Counsel Selected by or Acceptable to It That the Transfer May Lawfully Be Made Without Registration Under the Said Act.

NATIONAL INDUSTRIES, INC.

WARRANT TO PURCHASE
COMMON STOCK

No. W .....

Warrant to Purchase .....
Shares of Common Stock

This is to certify that for value received, ...
....
or registered assigns ("Holder") is entitled to purchase, subject to the provisions of this Warrant, from NATIONAL INDUSTRIES, INC., a Kentucky corporation ("Company"), with its principal place of business in Louisville, Kentucky, during the period commencing on .....* and ending at 3:30 P.M. Louisville Time, on .....*, ... fully paid and nonassessable shares of Common Stock at the purchase price of Twenty Four Dollars ($24.00) per share (the number of such shares and the purchase price applicable thereto being subject to adjustment as hereinafter set forth). This Warrant is one of a series of Warrants identical in form issued by the Company to purchase an aggregate of up to 125,000 shares of Common

Stock of the Company, and the term "Warrants" as used herein means all such Warrants including this Warrant.

1. Subject to the provisions of Paragraph 10 hereof, this Warrant may be exercised on or after *....., but not later than 3:30 P.M. Louisville Time on *....., in whole, or from time to time during such period in part, by presentation and surrender hereof to the principal office of the Company, with the Purchase Form annexed hereto duly executed and accompanied by the purchase price for the shares of stock specified in such form. Upon receipt by the Company of this Warrant at its principal office, in proper form for exercise, the Holder shall be deemed to be the Holder of record of the shares of Common Stock issuable upon such exercise, notwithstanding the fact that the stock transfer books of the Company shall be closed or that certificates representing such shares of Common Stock shall not then be actually delivered to the Holder. If this Warrant is not exercised in full, National shall deliver to the Holder hereof a new Warrant for the remaining shares as provided in Paragraph 4(a) hereof.

2. The Company hereby agrees that at all times there shall be reserved for issuance and/or delivery upon exercise of this Warrant such number of shares of its Common Stock as shall be required for issuance or delivery upon exercise of this Warrant, and that such shares of Common Stock will be listed, subject to official notice of issuance, on the New York Stock Exchange.

3. No fractional shares or scrip representing fractional shares shall be issued upon the exercise of this Warrant. With respect to any fraction of a share called for upon the exercise hereof, the Company shall pay to the Holder an amount in cash equal to such fraction multiplied by the current market value of a share of Common Stock, determined pursuant to the provision of Paragraph 6(e) hereof. For the purpose of this

* The period of exercise will be approximately 1 year commencing approximately five years from the consummation of the transaction contemplated in the January 30, 1969 agreement.

Paragraph 3, the computation of the value of any fractional interest in a share of Common Stock shall be made to the first two decimal places, without rounding.

4. (a) This Warrant is exchangeable, without expense, at the option of the Holder, upon presentation and surrender hereof to the Company for any other Warrants of different denominations entitling the holder thereof to purchase in the aggregate the same number of shares of Common Stock purchasable hereunder. This Warrant is transferable in the same manner and with the same effect upon payment of all federal and state taxes applicable to such transfer, subject to the provisions of Paragraph 10 hereof. Upon surrender of this Warrant to the Company with the Assignment Form annexed hereto duly executed, with funds sufficient to pay any transfer tax the Company shall, without charge, execute and deliver a new Warrant in the name of the assignee named in such instrument of assignment and this Warrant shall promptly be cancelled. If the Warrant is exercised in part the Company shall, without charge, execute and deliver a new warrant in the name of the Holder hereof covering the unexercised portion of this Warrant. If and when this Warrant is assigned in blank, the Company shall, subject to the provisions of Paragraph 10 hereof, treat the bearer hereof as the absolute owner of this Warrant for all purposes and the Company shall not be affected by any notice to the contrary. This Warrant may be divided or combined with other Warrants which carry the same rights upon presentation hereof at the office or agency of the Company maintained for that purpose, together with a writen notice specifying the names and denominations in which new Warrants are to be issued and signed by the Holder hereof. The term "Warrant" as used herein includes any Warrants into which this Warrant may be divided or exchanged, and the term Holder as used herein includes any holder of any

Warrant into which this Warrant may be divided or exchanged.

(b) Upon receipt by the Company of evidence satisfactory to it for the loss, theft, destruction or mutilation of this Warrant, and (in the case of loss, theft or destruction) of reasonably satisfactory indemnification, and upon surrender and cancellation of this Warrant, if mutilated, the Company will execute and deliver a new Warrant of like tenor and date. Any such new Warrant executed and delivered shall constitute an additional contractual obligation on the part of the Company, whether or not this Warrant so lost, stolen, destroyed, or mutilated shall be at any time enforceable by anyone.

5. The Holder shall not, by virtue hereof, be entitled to any rights of a shareholder in the Company, either at law or equity, and the rights of the Holder are limited to those expressed in the Warrant and are not enforceable against the Company except to the extent set forth herein.

6. The Purchase Price and the number of shares purchasable shall be adjusted from time to time as follows:

(a) In case the Company shall, while any of the Warrants are outstanding, (i) pay a dividend in shares of its Common Stock, (ii) subdivide its outstanding shares of Common Stock, (iii) combine its outstanding shares of Common Stock into a smaller number of shares, or (iv) issue by reclassification of its Common Stock any shares of stock of the Company, the number of shares of Common Stock or other securities purchasable upon the exercise of each Warrant then outstanding shall be the number of shares of Common Stock or other securities of the Company which the Holder would have owned or would have been entitled to receive after the happening of any of the events described above, had such Warant been exercised immediately prior to the happening of such

event. An adjustment made pursuant to this Subparagraph (a) shall become effective immediately after the opening of business on the day next following (x) the record day of such dividend or (y) the day upon which such subdivision, combination or reclassification shall become effective.

(b) In case the Company shall, while any of the warrants are outstanding, issue rights or warrants to all Holders of its Common Stock entitling them, for a period expiring within 45 days after the record date for the determination of shareholders entitled to recive such rights or warrants, to subscribe for or purchase shares of Common Stock at a price per share less than the current market price per share of Common Stock (as defined in Subparagraph (e) below) on such record date, the number of shares of Common Stock purchasable upon the exercise of each Warrant then outstanding shall be determined by multiplying the number of shares of Common Stock to which the Holder thereof was theretofore entitled to receive, upon the exercise thereof by a fraction, of which the numerator shall be the number of shares of Common Stock outstanding on the date of issuance of such rights or warrants plus the number of additional shares of Common Stock offered for subscription or purchase, and of which the denominator shall be the number of shares of Common Stock outstanding on the date of issuance of such rights or warrants plus the number of shares which the aggregate offering price of the total number of shares so offered would purchase at such current market price. Such adjustment shall be made whenever such rights or warrants are issued and shall become effective retroactively immediately after the record date for the determination of stockholders entitled to receive such rights or warrants.

(c) In case the Company shall, while any of the Warranst are outstanding, distribute to all Holders of its Common Stock any assets or evidences of indebtedness of the Company (other than any dividend in cash payable out of consolidated earnings or earned surplus, or distributions within Subparagraphs (a) or (b) hereof) of a value per share in excess of 5% of the current market price per share of the Common Stock (as defined in Subparagraph (e) below) in any consecutive 12-month period, or rights to subscribe to its debt securities or equity securities other than Common Stock, then in each such case the number of shares of Common Stock purchasable upon the exercise of such Warrant after the record date for such distribution shall be determined by multiplying the number of shares of Common Stock which the Holder thereof was theretofore entitled to receive, upon the exercise hereof, by a fraction, of which the numerator shall be the current market price per share of the Common Stock (as defined in Subparagraph (e) below) on the record date for such distribution, and of which the denominator shall be such current market price per share of the Common Stock at such record date, less the fair value of the portion of the assets or evidences of indebtedness or subscription rights so distributed applicable to one share of Common Stock. Value shall be determined by the Board of Directors of the Company whose determination shall be conclusive. For the purpose of this Subparagraph (c), consolidated earnings or earned surplus shall be computed by adding thereto all charges against earned surplus on account of dividends paid in shares of Common Stock in respect of which the purchase price has theretofore been adjusted, all as determined by the independent public accountants then regularly auditing the accounts of the Company; whose determination shall be conclusive.

(d) In the event of any adjustment of the total number of shares of Common Stock or other securities purchasable upon the exercise of the Warrants, the Purchase

Price per share shall be adjusted to be the amount resulting from dividing the number of shares (including fractional share interests) covered by such Warrants immediately after such adjustment into the total amount payable upon exercise of said Warrants in full immediately prior to such adjustment.

(e) For the purpose of any computation under Subparagraphs (b) and (c) above, the current market price per share of the Common Stock at any date shall be deemed to be the average of the daily closing prices for the twenty (20) consecutive business days commencing thirty-five (35) business days before such record date. The closing price for each day shall be the last reported sales price regular way or, in case no such reported sale takes place on such day, the average of the reported closing bid and asked prices regular way, in either case on the New York Stock Exchange or the American Stock Exchange or, if the Common Stock is not listed on either Exchange, the average of the closing bid and asked prices as furnished by any member of the New York Stock Exchange selected from time to time by the Company for such purpose. The term "business day" as used in this Subparagraph (e) means any day on which such Exchange shall be open for trading.

(f) No adjustment in the Purchase Price or the number of shares purchasable shall be made by reason of the issuance, in exchange for cash, property or services, of shares of Common Stock or any securities convertible into or exchangeable for shares of Common Stock or carrying the right to purchase any of the foregoing.

(g) No adjustment in the Purchase Price or the number of shares purchasable shall be required unless such adjustment would require an increase or decrease of at least $.50 in such price; provided, however, that any adjustment by reason of this Subparagraph (g) are not required to be made shall be carried forward and taken into account in any subsequent adjustment.

(h) For all purposes of this Warrant, the term "Common Stock" shall mean (i) the class of stock designated as the common stock of the Company at the date of this Warrant, or (ii) any other class of stock resulting from successive changes or reclassifications of such common stock. In the event that at any time as a result of an adjustment made pursuant to Subparagraph (a) above, the Holder of each Warrant shall become entitled to receive, upon the exercise thereof, any shares of the Company other than shares of its common stock as described in Clause (i) above, thereafter the number of such other shares so receivable upon the exercise thereof shall be subject to adjustment from time to time in a manner and on terms as nearly equivalent as practicable to the provisions with respect to the Common Stock contained in Subparagraphs (a) to (g), inclusive, and the provisions of each Warrant with respect to the shares of Common Stock shall apply on like terms to any such other shares.

7. Whenever the Purchase Price is adjusted as provided in Paragraph 6 above, the Company will promptly file in the custody of its Secretary or an Assistant Secretary at its principal office in Louisville, Kentucky, a certificate of a firm of independent public accountants of recognized standing selected by the Board of Directors (who may be the regular auditors of the Company) setting forth the Purchase Price as so adjusted, describing the corresponding adjustment in number of shares purchasable, stating that such adjusted Purchase Price conforms to the requirements of Paragraph 6, and setting forth a brief statement of the facts accounting for such adjustment. Such certificate shall be conclusive evidence of the correctness of such adjustment.

8. If, prior to the expiration date of this Warrant, the Company shall consolidate with or merge into another corporation (except for a merger or consolidation in which the Company is the continuing corporation), or in case the Company

shall sell or convey to any other person or persons all or substantially all of the property of the Company, the Holder of each Warrant then outstanding will thereafter be entitled to receive, upon the exercise thereof, the kind and amount of shares of stock, other securities, cash and property which he would have owned or been entitled to receive after such consolidation, merger, sale or conveyance had such Warrant been exercised immediately prior to the happening of such event. The Company shall take such steps in connection with such consolidation or merger as may be necessary to assure that the provisions of each such Warrant shall thereafter be applicable, as nearly as reasonably may be, in relation to any securities or property thereafter deliverable upon the exercise of each such Warrant.

9. (a) In the event that the Company files a registration statement under the Securities Act of 1933, as amended ("Act") which relates to a current offering of securities of the Company for its own account or the account of any of its shareholders (except in connection with an offering to employees or an exchange offer), such registration statement and the prospectus included therein shall also, at the written request to the Company by the Holder or Holders of 25,000 shares of common stock acquired upon exercise of the Warrants and/or which may be acquired upon exercise of the Warrants, relate to, and meet the requirements of the Act with respect to, any public offering of the shares of common stock so acquired or to be acquired so as to permit the public sale thereof in compliance with the Act. For purposes of this Subparagraph (a), the Holders referred to in the first sentence hereof are hereinafter called the "Owners". So long as there are outstanding Warrants to purchase 25,000 shares of Common Stock, or 25,000 shares of Common Stock have been delivered upon exercise of the Warrants, the Company shall give written notice to the Holder of its intention to file a registration statement under the Act relating to a current offering of the aforesaid

securities of the Company, thirty (30) or more days prior to the filing of such registration statement, and the written request provided for in the first sentence of this Subparagraph (a) shall be made by the Owners fifteen (15) or more days prior to the date specified in the notice as the date on which it is intended to file such registration statement. Neither the delivery of such notice by the Company nor of such request by the Owners shall in any way obligate the Company to file such registration statement and notwithstanding the filing of such registration statement, the Company may, at any time prior to the effective date thereof, determine not to offer the securities to which such registration statement relates, without liability to the Owners.

(b) In addition, upon written request from any Holder of 25,000 shares of Common Stock issued upon exercise of a Warrant that he or it contemplates the transfer of all or any of his or its Common Stock under such circumstances that a public offering, within the meaning of the Act, of the Common Stock will be involved, the Company, as promptly as possible after the receipt of such notice, shall file a Notification under Regulation A or other qualification, or a new registration statement with respect to the offering and sale or other disposition of the Common Stock with respect to which it shall have received such notice; provided, however, that any such notice received by the Company, may be given only at such times as shall permit the Company to use, in connection with such filing, pursuant to the requirements of the Act and the rules and regulations ("Rules and Regulations") of the Securities and Exchange Commission ("Commission") thereunder, audited year-end financial statements without unaudited statements for any interim periods, unless a specific request for unaudited financial statements shall have been made by the Commission after such filing. Within ten (10) days after receiving any such notice, the Company shall give notice to the other Holders advising that the Company is proceeding with such

Notification or other qualification or registration statement and offering to include therein Common Stock of such Holders. The Company shall not be obligated to any such other Holder unless such other Holder shall accept such offer by notice in writing to the Company within ten (10) days thereafter.

(c) In each instance in which pursuant to Subparagraphs (a) and (b) of this Paragraph 9, the Company shall take any action to permit a public offering and sale or other distribution of Common Stock, the Company shall:

(1) Supply to the Holders or their representatives two executed copies of the Notification under Regulation A or other qualification or of the new registration statement and as many copies of the preliminary, final and other prospectus or offering circular as such Holders may reasonably require for use in conformity with requirements of the Act and the Rules and Regulations and such other documents as the Holders or their representatives shall reasonably request;

(2) Cooperate in taking such action as may be necessary to register or qualify the Common Stock under such other securities acts or blue sky laws of such jurisdictions as the Holders or their representatives shall reasonably request and do any and all other acts and things which may be necessary or advisable to enable the Holders of such Common Stock to consummate such proposed sale or other disposition of the Common Stock in any jurisdiction; provided, however, that in no event shall the Company be obligated, in connection therewith, to qualify to do business or to file a general consent to service of process in any jurisdiction where it shall not then be qualified; and

(3) Keep effective for a period of ninety (90) days after the initial effectiveness thereof all such registrations

and qualifications under the Act and cooperate in taking such action as may be necessary to keep effective such other registrations and qualifications, and do any and all other acts and things for such period—not to exceed said ninety (90) days—as may be necessary to permit the public sale or other disposition of such Common Stock by such Holders;

(4) Indemnify and hold harmless each such Holder and each underwriter, within the meaning of the Act, who may purchase from or sell for any such Holder, any Common Stock, from and against any and all losses, claims, damages, and liabilities (including, but not limited to, any and all expenses whatsoever reasonably incurred in investigating, preparing, defending or settling any claim) arising from (i) any untrue or alleged untrue statement of a material fact contained in any Notification, qualification or in any registration statement covering shares of Common Stock of such Holder, or in any amendment or supplement thereto or any prospectus or offering circular included therein, or (ii) any omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading (unless such untrue statement or omission or such alleged untrue statement or omission was based upon information furnished or required to be furnished in writing to the Company by such Holder or underwriter expressly for use therein), which indemnification shall include each person, if any, who controls any such Holder or underwriter within the meaning of the Act; provided, however, that the Company shall not be so obligated to indemnify any such Holder or underwriter or controlling person unless such Holder and underwriter shall at the same time indemnify the Company, its directors, each

officer signing any registration statement or notification or any amendment to any registration statement or notification and each person, if any, who controls the Company within the meaning of the Act, from and against any and all losses, claims, damages, and liabilities (including, but not limited to, any and all expenses whatsoever reasonably incurred in investigating, preparing, defending or settling any claim) arising from (a) any untrue or alleged untrue statement of a material fact contained in any registration statement or notification or any amendment to any registration statement or notification, prospectus or offering circular covering shares of Common Stock of such Holder, or (b) any omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, based upon information furnished, or required to be furnished, in writing to the Company by such Holder or underwriter expressly for use therein. This indemnity agreement shall not inure to the benefit of any such underwriter (or to the benefit of any person who controls such underwriter) on account of any losses, claims, damages, liabilities (or actions or proceedings in respect thereof) arising from the sale of any of such Common Stock by such underwriter to any person if such underwriter failed to send or give a copy of the prospectus or offering circular furnished pursuant to the terms of this Warrant, as the same may then be supplemented or amended (if such supplement or amendment shall have been furnished to such underwriter pursuant to the terms of this Warrant to such person with or prior to the written conformation of the sale involved.

(5) The indemnity agreement contained in clause (4) of this Subparagraph (c), to the extent that such agreement requires the Company to indemnify and hold harmless against liabilities arising under the Act any person who controls any underwriter within the meaning of the Act, or who is a partner in or an associate of a firm which is such an underwriter, shall not inure to the benefit of such person if such person is also a director of the Company, except to the extent that such benefit shall be finally determined by a court of competent jurisdiction not to be against public policy as expressed in the Act or in the opinion of counsel for the Company the question shall have theretofore been decided by controlling precedent.

(d) The Company's obligations under Subparagraphs (a) and (b) of this Paragraph shall be conditioned as to each such public offering, upon a timely receipt by the Company in writing of:

(1) Information as to the terms of such public offering furnished by or on behalf of each Holder intending to make a public distribution of his or its Common Stock;

(2) Such other information as the Company may reasonably require from such Holders, or any underwriter for any of them, for inclusion in such registration statement or post-effective amendment; and

(3) Assurances from such Holders participating in any such registration that they will bear the expenses provided in Subparagraph (f) hereof.

(e) Any notices or certificates by the Company to any Holder and by any Holder to the Company shall be deemed delivered if in writing and delivered personally or sent by certified mail, if to a Holder, at his or its address set forth in the first paragraph hereof, or, if the Holder has designated, by notice in writing to the Company, any other address, to such other address, and, if to the Company, addressed to it at 510 W.

Broadway, Louisville, Kentucky, or if the Company has designated, by notice in writing to the Holder, any other address, to such other address.

(f) All costs and expenses incurred in connection with the preparation, filing, processing, cancellation or withdrawal of the applications, notifications or registrations hereinabove referred to shall be allocated among all of the Holders offering securities thereunder and, if the Company or other persons are offering securities thereunder, the Company and such other persons in the same proportion that the offering price of the securities to be offered by each bears to the aggregate offering price of all such securities offered thereunder. Such costs and expenses will include all accounting and legal fees, blue sky fees, costs incurred in connection therewith, costs and expenses of the Company's employees to the extent that the financial statements and other information used in connection with the application, notification or registration statement are prepared by such persons (but not including the costs and expenses incurred by the Company in connection with the regular and usual audit of its fiscal year-end financial statements); provided, however, that the costs and expenses of the Company's employees shall not exceed in the aggregate $5,000 for each such application, notification or registration statement.

(g) The Company shall not be required to comply with the requirements of Subparagraph (a) of this Paragraph 9 with respect to more than three registration statements and shall not be required to comply with the requirements of Subparagraph (b) of this Paragraph 9 with respect to more than one registration statement.

10. (a) This Warrant or the Common Stock or any other security issued or issuable upon exercise of this Warrant may not be sold, transferred or otherwise disposed of except as follows:

(1) to a person who, in the opinion of counsel selected by or acceptable to the Company, is a person to whom this Warrant or such Common Stock may legally be

transferred without registration and without the delivery of a current prospectus or offering circular under the Act with respect thereto and then only against receipt of an agreement of such person to comply with the provisions of this Paragraph 10 with respect to any resale or other disposition of such securities; or

(2) to any person upon delivery of a prospectus or offering circular then meeting the requirements of the Act relating to such securities and the offering thereof for such sale or disposition.

(b) The Company may cause to be endorsed on the certificates of Common Stock issuable upon exercise of this Warrant a legend substantially in the form of the legend appearing on the face of this Warrant.

Dated: ....., 1969.

NATIONAL INDUSTRIES, INC.

By _____

President

(Corporate Seal)

Attest:

_____

Secretary

Purchase Form

Dated ....., 19____

The undersigned hereby irrevocably elects to exercise the attached Warrant to the extent of purchasing _____ shares of Common Stock and hereby makes payment of $_____ in payment of the actual exercise price of $_____.

Instructions for Registration of Stock

Name .....
(please typewrite or print in block letters)

Address .....

Signature .....

Assignment Form

FOR VALUE RECEIVED, ...
hereby sells, assigns and transfers unto

Name .....
(please typewrite or print in block letters)

Address .....
the right to purchase Common Stock represented by the attached Warrant to the extent of _____ shares as to which such right is exercisable and does hereby irrevocably constitute and appoint _____, attorney, to transfer the same on the books of the Company with full power of substitution in the premises.

Signature .....

Dated: ....., 19____.

EXHIBIT "C"

Proxy

The undersigned, pursuant to the terms of a Stock Purchase Agreement dated as of January 30, 1969 between NATIONAL INDUSTRIES, INC., a Kentucky corporation (hereinafter called "National"), and certain Sellers, does hereby, effective from and after the date hereof, irrevocably constitute and appoint National, acting by or through its President or any Vice President, the attorney, agent and proxy of the undersigned with full power of substitution, to vote at any regular or special meeting of stockholders of TSC Industries, Inc., and any and all adjournments of any such meeting, all shares of the Common Stock and $.70 Cumulative Convertible Preferred Stock, registered in the name of the undersigned and presently represented by Certificate Nos. _____, with all the powers the undersigned would possess if personally present at any such meeting.

This Proxy is coupled with an interest and shall expire on June 30, 1969.

Dated: _____, 1969.

NATIONAL INDUSTRIES, INC.
510 Broadway
Louisville, Kentucky

February 6, 1969

Charles E. Schmidt
Dorothy F. Schmidt
Richard L. Schmidt
Charles E. Schmidt, Jr.
Charles E. and Dorothy F.
Schmidt Family Foundation
200 Oxford Road
Kenilworth, Illinois

Gentlemen:

This will confirm our understanding modifying and amending that certain Stock Purchase Agreement (the "Agreement"), dated as of January 30, 1969, between National Industries, Inc. ("National") and Charles E. Schmidt, Dorothy F. Schmidt, Richard L. Schmidt, Charles E. Schmidt, Jr., and Charles E. and Dorothy F. Schmidt Family Foundation (hereinafter collectively referred to as "Sellers").

(1) The provisions of paragraph 1 of the Agreement are hereby amended to read as follows:

"Each of the Sellers, respectively, agrees to sell to National, and National agrees to purchase from Sellers, subject to the terms and conditions hereof, that number of shares of $.70 Cumulative Convertible Preferred Stock, par value $1.00 per share, at a price of $22.50 per share, and that number of shares of common stock, par value $1.00 per share, at a price of $30.00 per share of TSC INDUSTRIES, INC., a Delaware corporation (hereinafter called "TSC"), set forth opposite each such Seller's name as follows:

SELLERS:	No. of Shares of TSC Sold: Common Shares	No. of Shares of TSC Sold: $.70 Cum. Preferred
Charles E. Schmidt	414,545	338,974
Dorothy F. Schmidt	5,297	30,000
Richard L. Schmidt	6,000	30,001
Charles E. Schmidt, Jr.	1,000	40,700
Charles E. and Dorothy F. Schmidt Family Foundation	7,840	—
Total	434,682	439,675

Each Seller, respectively, represents that, to the best of such Seller's knowledge, the number of shares of TSC set forth above opposite his name are all of the shares of TSC owned by such Seller, directly or indirectly."

(2) Paragraph 8 of the Agreement is hereby amended to read as follows:

"The parties, each for himself and itself represent and warrant that no broker or finder has been employed by any of them in connection with the transaction contemplated hereby, except for (i) Mr. Frank Cryan for whose fee Mr. Charles E. Schmidt shall be responsible and (ii) Henderson, O'Reilly & Co. (who has informed National that it has collaborated with Emanuel Deetjen & Company, Pershing & Company and Charles Valentine, and has agreed to compensate said firms and person out of the brokerage fees payable to it) for whose fee National shall be responsible, and that the fees payable by the respective parties as aforesaid are only payable upon consummation of the transaction contemplated hereunder. Each party agrees to indemnify and hold the other party harmless from any damages or expenses, including attorney's fees, which either party may suffer as a result of any claim of a broker or finder with whom it is

finally determined that the other party has dealt with in contravention of the above representation.

(3) Nothing herein contained shall be deemed to construe or treated to affect, modify or change the aforementioned Agreement or any of the provisions thereof, excepting in the manner and to the extent as in this Agreement expressly provided.

Please indicate your approval and agreement to the foregoing by signing the enclosed counterpart of this letter at the place provided and return the same to the undersigned.

Very truly yours,

NATIONAL INDUSTRIES, INC.

By .....
Gerald Weinstein

Accepted and Approved
February 7, 1969

.....
Charles E. Schmidt

.....
Dorothy F. Schmidt

.....
Richard L. Schmidt

.....
Charles E. Schmidt, Jr.

.....
Charles E. and Dorothy F.
Schmidt Family Foundation

DEPOSITION EXHIBIT 5:

Minutes, TSC Board of Directors,
October 16, 1969,
including

Letter from Hornblower & Weeks, et al. to TSC Board of Directors, October 16, 1969

Letter from Blancke Noyes to TSC Board of Directors, November 30, 1969

TSC INDUSTRIES, INC.
BOARD OF DIRECTORS MEETING

October 16, 1969

Pursuant to call of the Chairman of the Board by written notice to all directors on October 10, 1969, a special meeting of the Board of Directors of TSC Industries, Inc., a Delaware corporation, was held on Thursday, October 16, 1969 at 1:45 p.m. in the Board Room, LaSalle Hotel, Chicago, Illinois.

A quorum of directors was present as follows:

Max J. DeForest	Jack Segell
Blancke Noyes	Carl W. Sharfman
Orville Peterson	Allan B. Solomon
Richard H. Schaefer	Stanley R. Yarmuth

The remaining directors, Charles F. Simonelli and Hyman Ullner, were absent. Also present were Lawrence W. Schweik, secretary of the corporation, and Charles N. Salzman and Charles E. Gerber, counsel for the corporation. Mr. Yarmuth acted as Chairman and Mr. Schweik acted as secretary.

Mr. Yarmuth stated that the principal purpose of this special meeting was to consider and vote upon the proposed sale of substantially all of the assets of the corporation to a subsidiary of National Industries, Inc. in exchange for shares of National's $1.25 Series B Cumulative Convertible Preferred Stock and

National Warrants, the assumption by such subsidiary of substantially all of the corporation's liabilities and certain other undertakings by National and such subsidiary.

Each director was then furnished a preliminary copy of the Proxy Statement, including Exhibits A through D to the proxy statement, and also a copy of an appraisal report from Hornblower & Weeks-Hemphill, Noyes, dated October 16, 1969, the original copy of such appraisal report is attached hereto as Exhibit A.

At the request of Mr. Yarmuth, Mr. Solomon summarized various provisions of the proposed Agreement between this corporation and National. Firstly, he stated that this corporation would sell substantially all of its assets, subject to substantially all of its liabilities to a subsidiary of National in exchange for shares of National's $1.25 Series B Cumulative Convertible Preferred Stock and National Warrants, the terms and provisions of such securities being fully set forth in Appendices 1, 2 and 3 to the Agreement. Secondly, he stated that such sale was conditioned upon the adoption of a Plan of Complete Liquidation of the corporation (the "Plan") by the stockholders of the corporation. The Plan has been prepared, and the Agreement has been structured, so as to fall within the purview of Section 337 of the Internal Revenue Code of 1954, as amended, and the regulations promulgated thereunder. Thirdly, he stated, if the sale is consummated and the liquidation of the corporation is completed pursuant to the terms and provisions of the Plan, that National would realize a capital loss for federal income tax purposes, but not for financial reporting purposes, of approximately $9,400,000. Finally, he stated that consummation of the transactions contemplated by the Agreement was conditioned on numerous things, including listing the National Series B Preferred Stock and National Warrants on the New York and American Stock Exchanges, respectively.

Mr. Schaefer then stated that Mr. Yarmuth had recommended that the law firm of Friedman, Koven, Shapiro, Salzman,

Koenigsberg, Specks & Homer represent this corporation and that said law firm had been so retained. Said law firm has, in the past, represented National from time to time.

The directors then discussed the appraisal report of October 16, 1969 from Hornblower & Weeks-Hemphill, Noyes. Mr. Yarmuth stated that under the original proposal from National, the stockholders of the corporation would have received fewer shares and warrants than now proposed. Mr. Noyes then explained the analysis supporting the appraisal and stated that the present offer represents more than a 40% premium to the corporation's stockholders based on current market values. Mr. Noyes stated that Hornblower & Weeks-Hemphill, Noyes suggested the present terms as being a fair offer and that National accepted such proposal without any negotiation. Mr. Noyes stated that his firm appraised the National $1.25 Series B Preferred as a sound value and that even though there may be some decline in the price of the warrants, the exchange offer is a fair one. Mr. Noyes stated that National's ability to service its debt, including $13,000,000 in outstanding bank borrowings, was considered and that his firm was advised by National that it intends to use its best efforts to retire such bank borrowings by selling certain assets or by raising additional capital.

Mr. Schaefer then stated that the appraisal report had been furnished at the request of the corporation and was prepared without cost to the corporation. Mr. Noyes stated that his firm has no established relationship with National and that his firm is completely independent of National.

Mr. Salzman then referred to Mr. Schaefer's comments as to his firm's representation of the corporation and assured the directors that there was no conflict of interest. He stated that the transaction had been structured to minimize the federal income taxes at the corporate level. He further stated that the action of the directors would be proper in all respects. Mr. Gerber then reviewed the sequence of the four proposals as they would be placed before the corporation's stockholders.

The directors were then advised that the First National Bank of Chicago has given its verbal approval to the proposed agreement and that the bank was requiring that the assets of the corporation be kept together and intact in a separate viable subsidiary corporation of National, that National would be required to and has agreed to guarantee the corporation's loans and that the bank had further stipulated that such subsidiary may pay dividends to National only to the extent that earnings are more than $2,000,000 net after taxes for each year, such amount not being on a cumulative basis.

Mr. Solomon advised the directors that during the period beginning January 1, 1969 and ending September 30, 1969, National had purchased 48,300 shares of its own common stock at prices ranging from $10.00 to $16.25 per share.

Mr. Solomon stated that National recognized that this transaction would impose a tremendous tax burden on Orville Peterson, his brother and their families since they had a very low basis for the stock they hold in the corporation and he advised the directors that an agreement was being prepared under which National would acquire the shares of the Peterson families at approximately $14 per share, payable 10% in cash and the balance represented by notes maturing over a period of 5 years and bearing 5% interest per annum. Mr. Peterson stated that in view of the sale of his stock to National, he would abstain from voting on the proposals pertaining to the proposed agreement.

There being no further questions or discussion the directors proceeded to a vote on the proposed agreement. Messrs. Yarmuth, Solomon and Segell, all being associated with National, stated that while they are in complete accord with the proposed agreement and would have voted for the proposals, upon the advice of counsel they would abstain from voting on the proposals. Thereupon upon motion duly made, seconded and unanimously carried by the four disinterested directors, Messrs. Schaefer, DeForest, Sharfman and Noyes, the following resolutions were adopted:

Resolutions Relating to Amendments to the Certificate of Incorporation

RESOLVED, that this Board of Directors does hereby adopt and declare advisable an Amendment to Article First of the Certificate of Incorporation of the corporation so that said Article First, as amended, shall read as follows:

First. The name of the corporation is TS Liquidating Company.

FURTHER RESOLVED, that this Board of Directors does hereby adopt and declare advisable an Amendment to Article Fourth, Part 2, Section 2.5 of the Certificate of Incorporation of the corporation so that the said Article Fourth, Part 2, Section 2.5, as amended, shall read as follows:

2.5 Liquidation rights

2.51 In the event of any voluntary liquidation, dissolution or winding-up of the corporation, pursuant to any plan of complete liquidation adopted by the Board of Directors on or before December 1, 1969, before any distribution shall be made to the holders of common stock or any stock junior to the preferred stock as to liquidation, the holders of each share of preferred stock of each series shall be entitled to receive a preferential liquidating distribution consisting of certain securities of National Industries, Inc., a Kentucky corporation ("the National Securities") to wit: .6 share of $1.25 Series B Cumulative Convertible Preferred Stock ("National Preferred Stock"), and a warrant entitling the holders thereof to purchase one share of common stock of said National Industries, Inc., at a price of $21.40 per share at any time on or before October 31, 1978 ("National Warrant"). The holders of preferred stock shall not be entitled to receive any fractional interest in the National Securities upon liquidation. In lieu thereof, the holders of preferred stock shall have the right, exercisable any time prior to 60 days after the date on which the National Securities are issued to the corporation, to purchase an additional frac-

tional interest required for a full share of National Preferred Stock or a full National Warrant at the prevailing market price for National Preferred Stock on the New York Stock Exchange and for the National Warrant on the American Stock Exchange. In the event any preferred stockholder fails to elect to purchase an additional fractional interest within the aforementioned 60 day period, said stockholder shall be entitled to receive a cash payment (payable by check) equal to the price at which said fractional interest is sold on the New York Stock Exchange or the American Stock Exchange as the case may be. The holders of preferred stock, upon liquidation, shall be entitled to receive the above-mentioned preferential liquidating distribution and no more, and shall not be entitled to participate in any further liquidating distributions.

2.52 In the event of any involuntary liquidation, dissolution or winding up of the corporation occurring at any time, or any voluntary liquidation, dissolution or winding up (other than a liquidation, dissolution or winding up referred to in Section 2.51 above), and subject to the provisions of Part 4 hereof fixing the liquidation rights of holders of series 1 preferred stock and to the provisions of the resolutions of the board of directors providing for the issue of any other series of preferred stock that stock of such series shall rank on a parity with the series 1 preferred stock upon liquidation, the holders of preferred stock of each series shall be entitled to receive the full preferential amount, if any, fixed by the certificate of incorporation or by the resolutions of the board of directors providing for the issue of such series, including any arrearages in dividends thereon to the date fixed for the payment in liquidation, before any distribution shall be made to the holders of common stock or any stock junior to the preferred stock as to liquidation. After payment in full of such preferential amounts to the holders of the preferred stock of the respective series entitled thereto, the remaining assets of the corporation shall then be distributable exclusively among the holders of the series 1

preferred stock and preferred stock of any series ranking on a parity with series 1 preferred stock upon liquidation and the holders of common stock and any stock junior to the preferred stock outstanding as to liquidation, according to their respective interests.

2.53 If the assets of the corporation are insufficient to permit the payment of the full preferential amounts payable to the holders of the preferred stock of the respective series in the event of a liquidation, dissolution or winding-up, then the assets available for distribution to holders of the preferred stock of the respective series entitled to such preferential amounts shall be distributed ratably to such holders in proportion to the full preferential amounts payable on their respective shares upon liquidation.

2.54 A consolidation or merger of the corporation with or into one or more corporations or a sale, lease or exchange of all or substantially all of the assets of the corporation shall not be deemed to be a liquidation, dissolution or winding-up, voluntary or involuntary, within the meaning of this Section 2.5.

FURTHER RESOLVED, that this Board of Directors does hereby adopt and declare advisable an amendment to Article Fourth, Part 4, Section 4.3, of the Certificate of Incorporation of the corporation so that said Article Fourth, Part 4, Section 4.3, as amended, shall read as follows:

4.3 Liquidation rights

4.31 In the event of any voluntary liquidation, dissolution or winding-up of the corporation, pursuant to any plan of complete liquidation adopted by the Board of Directors on or before December 1, 1969, before any distribution shall be made to the holders of common stock or any stock junior to the series 1 preferred stock as to liquidation, the holders of each share of series 1 preferred stock shall be entitled to receive a preferential liquidating distribution consisting of certain securities of National Industries, Inc., a Kentucky corporation ("the National Securi-

ties"), to wit: .6 share of $1.25 Series B Cumulative Convertible Preferred Stock ("National Preferred Stock") and a warrant entitling the holders thereof to purchase one share of common stock of said National Industries, Inc., at a price of $21.40 per share at any time on or before October 31, 1978 ("National Warrant"). The holders of series 1 preferred stock shall not be entitled to receive any fractional interest in the National Securities upon liquidation. In lieu thereof, each holder of series 1 preferred stock shall have the right, exercisable any time prior to 60 days after the date on which the National Securities are issued to the corporation, to purchase an additional fractional interest required for a full share of National Preferred Stock or a full National Warrant at the prevailing market price for National Preferred Stock on the New York Stock Exchange and for the National Warrant on the American Stock Exchange. In the event any series 1 preferred stockholder fails to elect to purchase an additional fractional interest within the aforementioned 60 day period, said stockholder shall be entitled to receive a cash payment (payable by check) equal to the price at which said fractional interest is sold on the New York Stock Exchange or the American Stock Exchange as the case may be. The holders of series 1 preferred stock, upon liquidation, shall be entitled to receive the above mentioned preferential liquidating distribution and no more, and shall not be entitled to participate in any further liquidating distributions.

4.32 In the event of any involuntary liquidation, dissolution or winding-up of the corporation occurring at any time, any voluntary liquidation, dissolution or winding up (other than a liquidation, dissolution or winding up referred to in Section 4.31 above), (a) the holders of the series 1 preferred stock shall be entitled to receive an amount equal to all the arrearages in dividends thereon to the date fixed for the payment in liquidation, before any distribution shall be made to the holders of stock junior to the preferred stock, and (b) the holders of the series 1 preferred stock, the holders of any other series of preferred stock

ranking on a parity with the series 1 preferred stock upon liquidation as provided by the resolutions of the board of directors providing for the issue of such series and the holders of the common stock shall be entitled to share ratably in assets of the corporation available for distribution to them, subject to the condition that for this purpose the shares of series 1 preferred stock then outstanding shall be deemed to be the equivalent of the number of shares of common stock of the corporation (calculated to the nearest 1/100 of a share) into which they are by their terms convertible at the date fixed for payment in liquidation at the conversion rate in effect at that time and the ratio in which the shares of such other series shall share in such assets shall be determined in accordance with the resolutions of the board of directors providing for the issue of such series.

FURTHER RESOLVED, that this Board of Directors does hereby adopt and declare advisable an amendment to Article Fourth, Part 4, Section 4.51 of the Certificate of Incorporation of the Corporation so that said Article Fourth, Part 4, Section 4.51 as amended, shall read as follows:

4.51 Subject to and upon compliance with the provisions of this Section 4.5, the holder of any shares of series 1 preferred stock shall have the right at his option to convert all or any of such shares into fully paid and non-assessable shares of common stock of the corporation (calculated to the nearest 1/100 of a share) at the conversion rate of 0.75 share of common stock for each share of series 1 preferred stock, or in case an adjustment or adjustments in the conversion rate shall have taken place pursuant to provisions of subsection 4.55, then at the applicable conversion rate as so adjusted, provided, however, that such right of conversion shall terminate, (i) with respect to any shares called for redemption, at the close of business on the date fixed for redemption, unless the corporation shall default in the payment due upon redemption thereof, or, (ii) as of the close of business on the last regular business day prior to the date of consummation of any transaction whereby the corporation shall

cease doing business as a separate entity either as a result of merger, consolidation, or sale, lease, or exchange of all or substantially all of its assets. Notwithstanding the foregoing, if the last day for the exercise of the conversion right shall be, in any city in which the conversion agency is then maintained, a day on which banking institutions are authorized by law to close, then such conversion right may be exercised on the next succeeding day not a day on which banking institutions in such city are so authorized by law to close. No adjustment shall be made for dividends accumulated on any shares of series 1 preferred stock so converted nor for dividends on any common stock of the corporation that shall be issuable on any such conversion.

FURTHER RESOLVED, that the Board of Directors hereby recommends the adoption of the above amendments to its Certificate of Incorporation of the corporation and submits the same to the stockholders for approval at the special meeting of stockholders to be held for such purposes as provided below.

Resolutions Relating to the Complete Liquidation and Dissolution of TSC

WHEREAS, it is the judgment of the Board of Directors that it is advisable for the Corporation and to the benefit of the Corporation and its shareholders that the Corporation be liquidated and dissolved in accordance with the proposed Plan of Complete Liquidation submitted to this meeting, a copy of which is attached hereto as Exhibit B.

NOW, THEREFORE, BE IT RESOLVED that the proper officers of the Corporation be and they hereby are authorized to execute and deliver an Agreement (hereinafter referred to as the "Agreement"), dated as of October 16, 1969, between this corporation and National, substantially in the form submitted to this meeting with such changes as the officers and counsel of the Corporation shall deem advisable.

FURTHER RESOLVED, that the officers of this corporation be and they hereby are authorized in its name and on behalf to sell,

assign, transfer and convey the assets, properties and business of this corporation as provided in the Agreement and pursuant to the provisions of the Plan of Complete Liquidation in exchange for the assumption by a wholly-owned subsidiary of National of substantially all the liabilities of this corporation and in exchange for shares of National's $1.25 Series B Cumulative Convertible Preferred Stock and National Warrants, all as provided in the Agreement.

FURTHER RESOLVED, that the Board of Directors hereby recommends adoption of the Agreement and submits the same to the stockholders for approval at the special meeting of stockholders to be held for such purpose as provided below.

Resolutions Regarding Stockholders Meeting.

RESOLVED, that pursuant to the laws of the State of Delaware and the Certificate of Incorporation and By-laws of this Corporation, there is hereby called a special meeting of the stockholders of this Corporation, to be held on December 1, 1969, at 10:00 o'clock A.M., Chicago time, in Room 1848 LaSalle Bank Building, 135 South LaSalle Street, Chicago, Illinois, or as soon thereafter as practicable, for the following purposes:

A. To consider and act upon a proposal to amend the liquidation and conversion rights of this Corporation's Preferred Stock and the $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1, as provided in the resolutions above adopted by the Board of Directors.

B. To consider and act upon a proposal to adopt a Plan of Complete Liquidation of the Corporation in accordance with the resolutions above adopted by the Board of Directors.

C. To consider and act upon a proposal to approve the Agreement to be dated as of October 16, 1969, between this Corporation and National Industries, Inc., providing for the sale of substantially all of the assets, properties and business of this Corporation to a wholly owned subsidiary of National and the

assumption by such subsidiary of substantially all of the obligations and liabilities of this Corporation in exchange for securities of National in accordance with the resolutions above adopted by the Board of Directors.

D. To consider and vote upon a proposal to change the name of the Corporation to TS Liquidating Company in accordance with the resolutions above adopted by the Board of Directors.

E. To consider and vote upon such other matters as may properly come before the meeting.

FURTHER RESOLVED, that the above proposals shall be submitted to a vote of the stockholders in the order set forth above and unless each proposal is adopted and approved by the requisite vote of stockholders as hereinafter provided, none of the proposals shall be deemed to have been adopted and approved.

FURTHER RESOLVED, that in accordance with unanimous written consent of the Board of Directors of this Corporation dated October 14, 1969, only stockholders of record on October 24, 1969 shall be entitled to notice of and to vote at the above-mentioned special meeting of stockholders.

FURTHER RESOLVED, that at the special meeting of stockholders the proposal to amend the liquidation and conversion rights of the Preferred Stock and the $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1 ("Series 1 Preferred Stock") shall be submitted to a separate vote of the holders of Series 1 Preferred Stock and Common Stock, each voting separately as a class, and shall be deemed to have been adopted upon a favorable vote of at least two-thirds (⅔) of the shares of Series 1 Preferred Stock outstanding, and at least a majority of the shares of outstanding Common Stock. On all other matters the Series 1 Preferred Stock and Common Stock will vote together as a single class and the proposals shall be deemed to have been adopted upon a favorable vote of at least

a majority of the shares of Series 1 Preferred Stock and Common Stock outstanding.

FURTHER RESOLVED, that Mr. Richard H. Schaefer and Mr. Lawrence W. Schweik are hereby designated to serve as the proxies at the special meeting of stockholders to vote the shares of Series 1 Preferred Stock and Common Stock in accordance with the designation of stockholders, and if no designation is made, in favor of all of the above proposals.

FURTHER RESOLVED, that the Secretary of this Corporation is hereby directed to mail or cause to be mailed to all stockholders of this Corporation of record on October 24, 1969 a notice of the special meeting of stockholders, setting forth the date, time, place and purposes of said meeting, and to enclose with said notice a Proxy Statement and form of proxy in the form approved by the Board of Directors.

FURTHER RESOLVED, that the form of proxy submitted to the meeting is hereby adopted and approved, and the Secretary of the meeting is hereby directed to attach a copy thereof to the proceedings of this meeting.

FURTHER RESOLVED, that the draft of the Proxy Statement submitted to this meeting is hereby adopted and approved, and the proper officers of the Corporation are hereby directed to submit the requisite number of copies of said draft to the Securities and Exchange Commission, pursuant to the requirements of the Securities Exchange Act of 1934 and the regulations promulgated pursuant thereto, and to amend, modify and revise said Proxy Statement in accordance with the reasonable requests of the Securities and Exchange Commission.

Blue Sky Authorization

RESOLVED, that the officers of this corporation be and they hereby are authorized and empowered in the name and on behalf of this Corporation to file in any state such instruments or documents (including, without limitation, applications, surety bonds,

irrevocable consents, appointments of attorneys for service of process and registration of this Corporation as a broker or dealer) as in the opinion of counsel to this corporation may be desirable or necessary to effect the delivery of any of the National Securities as contemplated by the Agreement and as provided for in the Plan of Complete Liquidation. The execution by any such officer of any such instrument or the doing by them of any act in connection with the foregoing shall conclusively establish their authority therefor, hereby ratifying, approving and confirming all that any such officers may do by virtue hereof, their execution thereof to be conclusive evidence of such approval.

General

RESOLVED, that the proper officers of this corporation be and they hereby are authorized to execute, acknowledge, affix the corporate seal to (attested by the Secretary or any Assistant Secretary, if required and appropriate), deliver, file and record all agreements, certificates, documents and other instruments and to do all other acts and things, which they deem necessary or appropriate to carry out the intention of these resolutions, hereby approving, ratifying and confirming all that the said officers may do pursuant to the authority conferred to these resolutions.

FURTHER RESOLVED, that the officers of this corporation authorized to execute any of the documents, certificates or other written instruments provided for in any of the above resolutions shall be the Chairman of the Board, the President, any Vice President or the Treasurer together with, if required, the Secretary or any Assistant Secretary of the Corporation.

The directors then discussed the Agreement and Plan of Reorganization between this corporation and the shareholders of SAS, Inc., and, in particular, the provisions of Article I thereof. The President requested authority to accelerate the delivery of the "earn-out" shares of Series 1 Preferred Stock.

Upon motion duly made, seconded and unanimously carried, the following resolution was adopted:

RESOLVED, that Richard H. Schaefer, be and he hereby is authorized and empowered to compromise and settle the pretax earnings provisions of, and any and all other claims of the sellers, under the corporation's agreement to purchase all of the outstanding stock of SAS, Inc., on such terms and conditions as he may deem advisable including the delivery of up to 40,000 shares of $.70 Cumulative Convertible Stock (Preferred as to Dividends', Series 1 to the sellers as specified in the aforesaid agreement.

The directors then discussed the advisability of transferring certain assets down to a wholly owned subsidiary. After full discussion, upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED, that Richard H. Schaefer, president of the corporation, be and he hereby is authorized and empowered to select the assets and liabilities of this corporation to be transferred to Tractor Supply Co., a Delaware corporation, in exchange for the issuance of ten (10) shares of Tractor Supply Co. Common Stock, par value $100 per share, and the officers of this corporation be and they hereby are authorized and empowered to take all necessary and proper actions on behalf of the corporation to effect such transfer.

The directors then considered the resignation which had been tendered by Samuel P. Sharfman and on motion duly made and seconded the following resolution was adopted, Carl W. Sharfman abstaining:

RESOLVED, that the resignation of Samuel P. Sharfman as an officer and director of the corporation and its subsidiaries is accepted effective September 18, 1969 provided, however, that the payments under his employment contract of January 22, 1963 at the annual rate of $50,000 as extended by the board of directors of Community Discount Centers, Inc. on August

12, 1965, and deferred compensation agreement are to continue until January 31, 1970.

Mr. Schaefer then made a brief report on the current operations of both the Tractor and Community Divisions.

Mr. Noyes stated that he had been asked by several brokers to request that the directors consider giving a right of appraisal to the corporation's stockholders. It was pointed out that the stockholders have no appraisal rights under the laws of Delaware and the directors agreed that they would abide by the Delaware statutes.

There being no further business to come before the meeting, on motion duly made and seconded, the meeting was adjourned.

/s/ LAWRENCE W. SCHWEIK,
Secretary.

EXHIBIT A.

Since 1900
Hornblower & Weeks-Hemphill, Noyes
8 Hanover Street, New York, N. Y. 10004
DIgby 4-6600

October 16, 1969

The Board of Directors
TSC Industries, Inc.
4747 Ravenswood Avenue
Chicago, Illinois

Gentlemen:

You have requested that we analyze the terms of a proposed merger between your company, TSC Industries, and National Industries and advise you whether such terms are, in our opinion, fair and reasonable from the standpoint of the stockholders of TSC Industries. We understand that the proposed terms and the contemplated merger provide that each share of TSC common will receive 1½ warrants for the purchase of National Industries common at $21.40 and ½ share of National Industries Series B Convertible Preferred. We further understand that each share of TSC Industries $0.70 cumulative convertible preferred will receive one of the above warrants and .6 share of National Industries Series B Convertible Preferred.

To arrive at our opinion we considered, among other things, the current market prices of the securities of both companies, the high redemption price of the National Industries Series B Convertible Preferred, the dividend and debt service require-

ments of both companies, the substantial premium over current market values represented by the securities being offered to TSC shareholders, and the increased dividend income.

We believe that the terms of the proposed merger are fair and equitable to the shareholders of TSC Industries.

Sincerely yours,

/s/ HORNBLOWER & WEEKS-HEMPHILL, NOYES

Hornblower & Weeks-Hemphill, Noyes.

Since 1900
Hornblower & Weeks-Hemphill, Noyes
8 Hanover Street, New York, N. Y. 10004
DIgby 4-6600

November 30, 1969

Board of Directors
TSC Industries, Inc.
4747 N. Ravenswood Avenue
Chicago, Ill. 60640

Dear Sirs:

In my letter to you dated October 16, 1969, I made inadvertent use of the word "merger".

I understand the contemplated transaction is a sale of assets. This fact, however, does not in any way alter our opinion, which remains as stated in our letter of October 16th. That letter should be interpreted to apply to a sale of assets as well as a merger.

Sincerely,

/s/ BLANCKE NOYES,

Blancke Noyes.

BN:et

EXHIBIT B.

PLAN OF COMPLETE LIQUIDATION
OF
TSC INDUSTRIES, INC.

The Plan of Complete Liquidation (the "Plan") is intended to carry out the complete liquidation and dissolution of TSC INDUSTRIES, INC., a Delaware corporation (the "Company"), and is as follows:

1. The Board of Directors of the Company shall adopt a resolution deeming it advisable, in the judgment of the Board of Directors, that the Company be completely liquidated and dissolved.

2. The Board of Directors shall approve the Plan and shall recommend the adoption of the Plan by the stockholders of the Company at a special meeting of the stockholders called for that purpose.

3. The Plan shall be deemed adopted upon the approval thereof at a special meeting of stockholders by the affirmative vote of the holders of record of a majority of the outstanding stock of the Company.

4. Subject to the authorization and approval, by the affirmative vote of the holders of a majority of the outstanding stock of the Company at a special meeting of stockholders called for that purpose, of the Agreement, dated as of October 16, 1969, between the Company and National Industries, Inc., a Kentucky corporation ("National"), and the transactions provided for in the Agreement, the Company shall, after the Plan shall become effective, sell its assets, properties and business, subject to substantially all of its liabilities, obligations and commitments, to a wholly-owned subsidiary of National ("Transferee") organized for that purpose in consideration of (i) the issuance by National of the

National securities as provided in Section 2(a)(i) and (ii) of the Agreement and (ii) certain undertakings by National and Transferee, all pursuant to and upon the terms and conditions set forth in the Agreement (the date of such sale is herein called the "Closing Date").

5. Subsequent to the Closing Date, and prior to November 30, 1970, the Company shall pay and discharge, or otherwise satisfy or provide for the satisfaction of, all of the Company's liabilities, obligations and commitments not assumed or agreed to be performed or discharged by Transferee or National pursuant to the Agreement.

6. Subsequent to the Closing Date, and in any event prior to November 30, 1970, the Company shall distribute or cause to be distributed to its stockholders, as provided in its Certificate of Incorporation as amended prior to the Closing Date, all of the assets and property of the Company of every kind and nature whatsoever (including the National securities issued and delivered to the Company on the Closing Date), except sufficient cash required to satisfy the liabilities, obligations and commitments of the Company not transferred to or assumed by National or Transferee under the terms and provisions of the Agreement, all in complete redemption and cancellation of all of the outstanding stock of the Company and in complete liquidation of the Company. To effectuate the distribution of assets of the Company as aforesaid, the stockholders appoint The First National Bank of Chicago as Exchange Agent and trustee for the stockholders (herein called the "Trustee"), and the Company shall promptly deposit the National securities with the Trustee to be held for the account of the stockholders of the Company, pursuant to an Agreement to be entered into among the Company, National and the Trustee. Such Agreement shall provide, among other things, as follows:

(a) Upon surrender to the Trustee of certificates representing shares of $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1 of the Company

("Series 1 Preferred Stock") by the holder thereof, the Trustee shall forthwith deliver to such stockholder the National securities to which such stockholder is entitled pursuant to the terms and provisions of the Certificate of Incorporation of the Company, as amended.

(b) Upon surrender to the Trustee of certificates representing shares of Common Stock of the Company by the holder thereof, the Trustee shall forthwith deliver to such stockholder the securities to which such stockholder is entitled pursuant to the terms and provisions of the Certificate of Incorporation of the Company, as amended.

(c) Neither fractional shares of National's $1.25 Series B Cumulative Convertible Preferred Stock ("National Series B Preferred Stock") nor fractional interests in a National Warrant will be issued. Any stockholder who would be entitled to a fractional interest in a share of National Series B Preferred Stock or in a National Warrant will be given an opportunity to instruct the Trustee, within a period of 60 days following the Closing Date, either

(i) to purchase for his account, to the extent available, a sufficient additional fraction of a share or fraction of a warrant to entitle him to receive a full share or warrant, as the case may be; or

(ii) to sell any such fractional share or fractional interest in a warrant for his account and to deliver the proceeds of such sale to him.

If any stockholder, upon surrender of his Company's stock certificates, fails to give appropriate instructions, his fractional interests will be sold for his account. All fractional interests of stockholders who have not surrendered their stock certificates within such 60 day period will be aggregated and sold for the respective accounts of said stockholders.

(d) Any National securities deposited with the Trustee remaining unclaimed in the hands of the Trustee on the

sixth anniversary of the Closing Date as defined in Section 9 of the Agreement will be turned over by the Trustee to National to be held for the account and benefit of the Company's stockholders entitled thereto subject to any applicable escheat, abandoned property, or similar laws.

(e) Notwithstanding anything contained in this paragraph 6 to the contrary, the Trustee will not distribute in liquidation the National securities to the former shareholders of SAS, Inc. in exchange for 40,000 shares of Series 1 Preferred Stock if such shares are issued to said former SAS, Inc. stockholders by the Company on or prior to the Closing Date, until six months from the Closing Date or 365 days from the TSC's stockholders meeting at which this Plan is adopted, whichever first occurs.

(f) All costs in connection with the receipt and distribution of the National securities and the handling of fractional interests, including all transfer taxes (other than on transfers from one stockholder to another) and the fees and expenses of the Trustee will be paid by the Company.

7. Subsequent to the transfer of the National securities to the Trustee as provided in paragraph 6 above, the Company shall be dissolved and for that purpose shall cause a Certificate of [Dissolution] to be executed, acknowledged and filed in the Office of the Secretary of State of Delaware pursuant to Section 275 of the General Corporation Law of Delaware; shall take such other action as may be necessary for its dissolution; and shall withdraw its authority to do business as a foreign corporation in each state in which it now has authority.

8. The officers and directors of the Company shall do and perform all acts, execute all documents, file all reports, statements, certificates and returns, take all action and enter into all transactions in the name and on behalf of the Company both before and after the dissolution of the Company which they shall deem necessary or desirable to perform the Company's

undertakings in the Agreement, to wind up the business and affairs of the Company, and to complete the distribution of all of the Company's assets to the stockholders of the Company in complete liquidation of the Company subject, however, to the provisions of this Plan.

9. This Plan shall become effective on the date of its adoption and approval by the affirmative vote of the holders of a majority of the outstanding stock of the Company given at a special meeting of the stockholders duly called for such purpose and shall have no force and effect before such date.

10. It is intended that the Plan shall be a Plan of Complete Liquidation within the terms of Section 337 of the Internal Revenue Code of 1954. The Plan shall be deemed to authorize such further action as, in the opinion of counsel for the Company, may be necessary to conform with the provisions of such Section 337.

11. The Plan shall terminate and be of no further force or effect whatsoever if on or before June 30, 1970 the Company, for any reason, shall not have sold its assets, properties and business subject to substantially all its liabilities, obligations and commitments to National pursuant to the terms of the Agreement.

Preliminary Copy

TSC INDUSTRIES, INC.

This proxy is solicited on behalf of the management

The undersigned stockholder of TSC Industries, Inc., a Delaware corporation ("TSC"), does hereby constitute and appoint Richard H. Schaefer and Lawrence W. Schweik, and each or either of them, the attorneys and proxies of the undersigned, with full power of substitution, for and in the name and place of the undersigned, to attend the special meeting of stockholders of TSC to be held in Room 1818, La Salle Bank Building, 135 South La Salle Street, Chicago, Illinois, on Monday, December 1, 1969, at the hour of 10:00 A.M. Chicago time, or at any adjournment thereof, and to vote upon the matters set forth in the notice of such meeting as follows:

(1) FOR ☐ AGAINST ☐ approval of an amendment to the Certificate of Incorporation, as amended, of TSC to modify and amend the liquidation and conversion rights of the holders of Preferred Stock and $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1.

(2) FOR ☐ AGAINST ☐ adoption of the Plan of Complete Liquidation of TSC and the appointment of an Exchange Agent and Trustee for the stockholders as described in TSC's Proxy Statement.

(3) FOR ☐ AGAINST ☐ approval of an Agreement providing for the sale of substantially all the assets, property and business of TSC to a newly organized wholly-owned subsidiary of National Industries, Inc. as described in TSC's Proxy Statement.

(4) FOR ☐ AGAINST ☐ approval of an amendment to the Certificate of Incorporation, as amended, of TSC to change its name to TS Liquidating Company.

(5) For the transaction of such other business as may properly come before the meeting.

The Proxies will vote the shares represented hereby as directed by the stockholders, but will vote such shares in favor of the propositions stated in (1), (2), (3) and (4) above if the stockholder does not indicate how he wishes his shares voted on such propositions. Please sign below and mail in enclosed envelope.

The undersigned acknowledges receipt of the notice of meeting and the related Proxy Statement.

_____ (Seal)

Dated: _____, 1969 _____ (Seal)

Note: Please sign exactly as your name or names appear hereon. If you sign as agent or in any other representative capacity, please state the capacity in which you sign. Where there is more than one owner, each must sign.

DEPOSITION EXHIBIT 9:

TSC INDUSTRIES, INC.

BY-LAWS

Article I

Offices

Section 1. The registered office of the corporation in Delaware shall be in the City of Wilmington, County of New Castle.

Section 2. The corporation may also have offices at such other places both within and without the State of Delaware as the board of directors may from time to time determine or the business of the corporation may require.

Article II

Meeting of Stockholders

Section 1. All meetings of the stockholders for the election of directors shall be held in the City of Chicago, State of Illinois, at such place as may be fixed from time to time by the board of directors, or at such other place either within or without the State of Delaware as shall be designated from time to time by the board of directors and stated in the notice of the meeting. Meetings of stockholders for any other purpose may be held at such time and place, within or without the State of Delaware, as shall be stated in the notice of the meeting or in a duly executed waiver of notice thereof.

Section 2. Annual meetings of stockholders, commencing with the year 1969, shall be held at 11:00 A. M. on the second Monday in February of each year if not a legal holiday, or if a legal holiday, then on the next secular day following, or at such other date and time as shall be designated from time to time by the board of directors and stated in the notice of the meeting, at which they shall elect by a plurality vote by ballot a board of

directors, and transact such other business as may properly be brought before the meeting.

Section 3. Written notice of the annual meeting stating the place, date and hour of the meeting shall be given to each stockholder entitled to vote at such meeting not less than ten or more than fifty days before the date of the meeting.

Section 4. The officer who has charge of the stock ledger of the corporation shall prepare and make, at least ten days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held. The list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

Section 5. Special meetings of the stockholders, for any purpose or purposes, unless otherwise prescribed by statute or by the certificate of incorporation, may be called by the chairman of the board and shall be called by the chairman of the board or secretary at the request in writing of a majority of the board of directors, or at the request in writing of stockholders owning a majority in amount of the entire capital stock of the corporation issued and outstanding and entitled to vote. Such request shall state the purpose or purposes of the proposed meeting.

Section 6. Written notice of a special meeting stating the place, date and hour of the meeting and the purpose or purposes for which the meeting is called, shall be given not less than ten

or more than fifty days before the date of the meeting, to each stockholder entitled to vote at such meeting.

Section 7. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice.

Section 8. The holders of a majority of the shares of stock issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum at all meetings of the stockholders for the transaction of business except as otherwise provided by statute or by the certificate of incorporation. If, however, such quorum shall not be present or represented at any meeting of the stockholders, the stockholders entitled to vote thereat, present in person or represented by proxy, shall have power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present or represented. At such adjourned meeting at which a quorum shall be present or represented any business may be transacted which might have been transacted at the meeting as originally notified. If the adjournment is for more than thirty days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

Section 9. When a quorum is present at any meeting, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which by express provision of the statutes or of the certificate of incorporation, a different vote is required in which case such express provision shall govern and control the decision of such question.

Section 10. Each stockholder shall at every meeting of the stockholders be entitled to one vote in person or by proxy for each share of the capital stock having voting power held by such stockholder, but no proxy shall be voted or acted upon

after three years from its date, unless the proxy provides for a longer period.

Section 11. Whenever the vote of stockholders at a meeting thereof is required or permitted to be taken for or in connection with any corporate action, by any provision of the statutes, the meeting and vote of stockholders may be dispensed with: (a) if all of the stockholders who would have been entitled to vote upon the action if such meeting were held shall consent in writing to such corporation action being taken; or (b) if the certificate of incorporation authorizes the action to be taken with the written consent of the holders of less than all of the stock who would have been entitled to vote upon the action if a meeting were held, then on the written consent of the stockholders having not less than such percentage of the total number of votes as may be authorized in the certificate of incorporation; provided that in no case shall the written consent be by the holders of stock having less than the minimum percentage of the total vote required by statute for the proposed corporate action, and provided that prompt notice must be given to all stockholders of the taking of corporate action without a meeting and by less than unanimous written consent.

ARTICLE III

Directors

Section 1. The number of directors which shall constitute the whole board of directors shall be not less than three nor more than fifteen. The first board shall consist of three directors. Thereafter, within the limits specified above, the number of directors which shall constitute the whole board of directors shall be determined by resolution of the board of directors or by the stockholders at the annual meeting. The directors shall be elected at the annual meeting of the stockholders, except as provided in Section 2 of this Article, and each director elected

shall hold office until his successor is elected and qualified or until his earlier resignation or removal. Directors need not be stockholders.

Section 2. Vacancies and newly created directorships resulting from any increase in the authorized number of directors may be filled by a majority of the directors then in office, though less than a quorum, or by a sole remaining director, and each director so chosen shall hold office until the next annual election and until his successor is elected and qualified, or until his earlier resignation or removal.

Section 3. The business of the corporation shall be managed by its board of directors which may exercise all such powers of the corporation and do all such lawful acts and things as are not by statute or by the certificate of incorporation or by these bylaws directed or required to be exercised or done by the stockholders.

Meetings of the Board of Directors

Section 4. The board of directors of the corporation may hold meetings, both regular and special, either within or without the State of Delaware.

Section 5. The first meeting of each newly elected board of directors shall be held at such time and place as shall be fixed by the vote of the stockholders at the annual meeting and no notice of such meeting shall be necessary to the newly elected directors in order legally to constitute the meeting, provided a quorum shall be present. In the event of the failure of the stockholders to fix the time or place of such first meeting of the newly elected board of directors, or in the event such meeting is not held at the time and place so fixed by the stockholders, the meeting may be held at such time and place as shall be specified in a notice given as hereinafter provided for special meetings of the board of directors, or as shall be specified in a written waiver signed by all of the directors.

Section 6. Regular meetings of the board of directors may be held without notice at such time and at such place as shall from time to time be determined by the board.

Section 7. Special meetings of the board may be called by the chairman of the board on two days' notice to each director, either personally or by mail or by telegram; special meetings shall be called by the chairman of the board or secretary in like manner and on like notice on the written request of two directors.

Section 8. At all meetings of the board a majority of the total number of directors then constituting the whole board shall constitute a quorum for the transaction of business and the vote of a majority of the directors present at any meeting at which there is a quorum shall be the act of the board of directors, except as may be otherwise specifically provided by statute or by the certificate of incorporation. If a quorum shall not be present at any meeting of the board of directors the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

Section 9. Unless otherwise restricted by the certificate of incorporation or these by-laws, any action required or permitted to be taken at any meeting of the board of directors or of any committee thereof may be taken without a meeting, if all members of the board or committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the board or committee.

Committees of Directors

Section 10. The board of directors may, by resolution passed by a majority of the whole board, designate one or more committees, each committee to consist of two or more of the directors of the corporation. The board may designate one or more directors as alternate members of any committee, who

may replace any absent or disqualified member at any meeting of the committee. Any such committee, to the extent provided in the resolution, shall have and may exercise the powers of the board of directors in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it; provided, however, that in the absence or disqualification of any member of such committee or committees, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the board of directors to act at the meeting in the place of any such absent or disqualified member. Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the board of directors.

Section 11. Each committee shall keep regular minutes of its meetings and report the same to the board of directors when required.

[Compensation] of Directors

Section 12. The directors may be paid their expenses, if any, of attendance at each meeting of the board of directors and may be paid a fixed sum for attendance at each meeting of the board of directors or a stated salary as director. No such payment shall preclude any director from serving the corporation in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

ARTICLE IV

Notices

Section 1. Notices to directors and stockholders shall be in writing and delivered personally or mailed to the directors or stockholders at their addresses appearing on the books of the corporation. Notice by mail shall be deemed to be given

at the time when the same shall be mailed. Notice to directors may also be given by telegram.

Section 2. Whenever any notice is required to be given under the provisions of the statutes or of the certificate of incorporation or of these by-laws, a waiver thereof in writing signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed equivalent thereto.

ARTICLE V

Officers

Section 1. The officers of the corporation shall be a chairman of the board, a president, one or more vice presidents (the number thereof to be determined by the board of directors and one or more of whom may be designated as executive vice presidents), a secretary and a treasurer, and such assistant secretaries, assistant treasurers or other officers as may be elected or appointed by the board of directors. Any two or more offices may be held by the same person, except that no one person may hold the offices of both chairman of the board and secretary.

Section 2. The board of directors at its first meeting after each annual meeting of stockholders shall elect a chairman of the board and a president from among the directors and shall elect one or more vice presidents, a secretary, a treasurer and such assistant officers or other officers as it shall deem advisable.

Section 3. The board of directors may from time to time appoint such other officers and agents as it shall deem advisable, who shall hold their offices for such terms and shall perform such duties as from time to time may be prescribed by the board of directors.

Section 4. The salaries of all officers of the corporation shall be fixed by the board of directors.

Section 5. Each officer of the corporation shall hold office until his successor is chosen and qualified or until his earlier

removal. Any officer elected or appointed by the board of directors may be removed at any time by the affirmative vote of a majority of the board of directors. Any vacancy occurring in any office of the corporation shall be filled by the board of directors.

The Chairman of the Board

Section 6. The chairman of the board shall be the chief executive officer of the corporation and shall in general supervise and control all of the business and affairs of the corporation. He may sign, with the secretary or any other proper officer of the corporation thereunto authorized by the board of directors, certificates for shares of the corporation, any deeds, mortgages, bonds, contracts, or other instruments which the board of directors has authorized to be executed, except in cases where the signing and execution thereof shall be expressly delegated by the board of directors or by these by-laws to some other officer or agent of the corporation, or shall be required by law to be otherwise signed or executed, and in general he shall perform all duties incident to the office of chairman of the board and such other duties as from time to time may be prescribed by the board of directors. When present he shall preside at all meetings of the stockholders and of the board of directors.

The President

Section 7. The president shall be the second ranking officer of the corporation. In the absence of the chairman of the board, or in the event of his inability or refusal to act, the president shall perform the duties of the chairman of the board and when so acting shall have all the powers of, and be subject to all the restrictions upon, the chairman of the board. He may sign, with the secretary or any other proper officer of the corporation thereunto authorized by the board of directors, certificates for shares of the corporation, any deeds, mortgages, bonds, contracts, or other instruments which the board of

directors has authorized to be executed, except in cases where the signing and execution thereof shall be expressly delegated by the board of directors or by these by-laws to some other officer or agent of the corporation, or shall be required by law to be otherwise signed or executed, and in general he shall perform all duties incident to the office of president and such other duties as from time to time may be prescribed by the board of directors or the chairman of the board.

The Vice Presidents

Section 8. In the absence of the president, or in the event of his inability or refusal to act, the vice president (or if there be more than one, the executive vice president, or if there be no executive vice president the vice presidents in the order designated, or in the absence of any designation then in the order of their election or in the order named for election) shall perform the duties of the president and when so acting shall have all the powers of, and be subject to all the restrictions upon, the president. The vice presidents shall perform such other duties and have such other powers as from time to time may be prescribed by the board of directors, the chairman of the board or the president.

The Secretary

Section 9. The secretary shall: (a) keep the minutes of the stockholders' and the board of directors' meetings in one or more books provided for that purpose; (b) see that all notices are duly given in accordance with the provisions of these by-laws or as required by law; (c) be custodian of the corporate records and of the seal of the corporation and see that the seal of the corporation is affixed to all certificates for shares prior to the issue thereof and to all documents, the execution of which on behalf of the corporation under its seal is duly authorized in accordance with the provisions of these

by-laws; (d) keep or cause to be kept a register of the mailing address of each stockholder which shall be furnished to the secretary or any transfer agent of the corporation by such stockholder; (e) sign with the chairman of the board, the president or a vice president, certificates for shares of the corporation, the issue of which shall have been authorized by resolution of the board of directors; (f) have general charge of the stock transfer books of the company; and (g) in general perform all duties incident to the office of secretary and such other duties as from time to time may be prescribed by the board of directors, the chairman of the board or the president.

The Treasurer

Section 10. If required by the board of directors, the treasurer shall give a bond for the faithful discharge of his duties in such sum and with such surety or sureties as the board of directors shall determine. He shall: (a) have charge and custody of and be responsible for all funds and securities of the corporation, and the deposit of all moneys in the name of the corporation in such banks, trust companies or other depositaries as shall be selected in accordance with these by-laws; and (b) in general perform all the duties incident to the office of treasurer and such other duties as from time to time may be prescribed by the board of directors, the chairman of the board or the president.

The Assistant Treasurers and Assistant Secretaries

Section 11. The assistant secretaries as thereunto authorized by the board of directors may sign with the chairman of the board, the president or vice president certificates for shares of the corporation, the issue of which shall have been authorized by a resolution of the board of directors. The assistant treasurers shall respectively, if required by the board of directors, give bonds for the faithful discharge of their duties in such sums and

with such sureties as the board of directors shall determine. The assistant secretaries and assistant treasurers in general shall perform such duties as from time to time may be prescribed by the secretary or the treasurer, respectively, or by the board of directors, the chairman of the board or the president.

Other Officers

Section 12. Such other officers as shall from time to time be appointed by the board of directors shall perform such duties as from time to time may be prescribed by the board of directors, the chairman of the board or the president.

Article VI

Contracts, Loans, Checks and Deposits

Section 1. The board of directors may authorize any officer or officers, agent or agents, to enter into any contract or execute and deliver any instrument in the name of and on behalf of the corporation, and such authority may be general or confined to specific instances.

Section 2. No loans shall be contracted on behalf of the corporation and no evidences of indebtedness shall be issued in its names unless authorized by a resolution of the board of directors. Such authority may be general or confined to specific instances.

Section 3. All checks, drafts or other orders for the payment of money, notes or other evidences of indebtedness issued in the name of the corporation shall be signed by such officer or officers, agent or agents of the corporation and in such manner as shall from time to time be determined by resolution of the board of directors.

Section 4. All funds of the corporation not otherwise employed shall be deposited from time to time to the credit of

the corporation in such banks, trust companies or other depositaries as the board of directors may select.

Article VII

Certificates For Shares and Their Transfer

Section 1. Each holder of stock in the corporation shall be entitled to have a certificate signed by or in the name of the corporation by the chairman of the board, the president or a vice president and by the secretary or an assistant secretary of the corporation, and sealed with the seal or a facsimile of the seal of the corporation. If such certificate is countersigned (a) by a transfer agent other than the corporation or its employee, or (b) by a registrar other than the corporation or its employee, the signatures of the officers of the corporation may be facsimilies. In case any officer who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer before such certificate is issued, it may be issued by the corporation with the same effect as if he were such officer at the date of issue. In case the seal of the corporation is changed after the certificate is sealed with the seal or a facsimile of the seal of the corporation, but before it is issued, the certificate may be issued by the corporation with the same effect as if the seal had not been changed.

Section 2. Upon surrender to any transfer agent of the corporation of a certificate for shares of the corporation duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, it shall be the duty of the corporation to issue a new certificate to the person entitled thereto and cancel the old certificate and record the transaction on the books of the corporation. The person in whose name shares stand on the books of the corporation shall be deemed the owner thereof for all purposes as regards the corporation.

Section 3. The board of directors may appoint one or more transfer agents and one or more registrars of transfers, and

may require all stock certificates to be countersigned by such transfer agent and registered by such registrar. The board of directors shall have authority to make or approve rules and regulations concerning the issue, transfer and registration of certificates for shares.

Section 4. The board of directors may authorize the issuance of a new certificate in lieu of a certificate alleged by the holder thereof to have been stolen, lost, mutilated or destroyed, upon compliance by such holder, or his legal representatives, with such requirements as the board of directors may impose or authorize. Such authorization by the board of directors may be general or confined to specific instances.

ARTICLE VIII

Waiver of Notice

Whenever any notice whatever is required to be given under the provisions of these by-laws or under the provisions of the certificate of incorporation or under the provisions of the Delaware General Corporation Law, a waiver thereof in writing, signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent to the giving of such notice.

ARTICLE IX

Indemnification of Directors, Officers, Employees and Agents

Section 1. The corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of

the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit, or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe that his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe, that his conduct was unlawful.

Section 2. The corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable for negligence or misconduct in the performance of his duty to the corporation unless and only to the extent that the Court of Chancery of the State of Delaware or the

court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

Section 3. To the extent that a person who is or was a director, officer, employee or agent of the corporation, or of any other corporation, partnership, joint venture, trust or other enterprise with which he is or was serving in such capacity at the request of the corporation, has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Sections 1 and 2 of this Article, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.

Section 4. Any indemnification under Sections 1 and 2 of this Article (unless ordered by a court) shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in Sections 1 and 2. Such determination shall be made (a) by the board of directors by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding, or (b) if such a quorum is not obtainable, or, even if obtainable and a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, or (3) by the stockholders.

Section 5. Expenses incurred in defending a civil, criminal, administrative or investigative action, suit or proceeding, or threat thereof, may be paid by the corporation in advance of the final disposition of such action, suit or proceeding as authorized by the board of directors in the specific case, upon receipt of an undertaking by or on behalf of the director, officer, employee or agent to repay such amount unless it shall ultimately

be determined that he is entitled to be indemnified by the corporation as authorized in this Article.

Section 6. The indemnification provided by this Article shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any by-law, agreement, vote of stockholders or disinterested directors, or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

Section 7. The corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against liability under the provisions of this Article or of Section 145 of the General Corporation Law of the State of Delaware.

Section 8. The invalidity or unenforceability of any provision in this Article shall not affect the validity or enforceability of the remaining provisions of this Article.

ARTICLE X

General Provisions

Seal

Section 1. The corporate seal shall have inscribed thereon the name of the corporation, the year of its organization and the words "Corporate Seal, Delaware". The seal may be used

by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

Fiscal Year

Section 2. The fiscal year of the corporation shall be fixed by resolution of the board of directors.

ARTICLE XI

Amendments

Section 1. These by-laws may be altered, amended or repealed and new by-laws may be adopted at any meeting of the board of directors held pursuant to notice duly given.

DEPOSITION EXHIBIT 15:

TSC INDUSTRIES, INC.

SPECIAL MEETING OF BOARD OF DIRECTORS

February 5, 1969

A special meeting of the board of directors of TSC INDUSTRIES, INC., a Delaware corporation was held on February 5, 1969, at the hour of 9:30 o'clock a.m. at the offices of the corporation, 4747 North Ravenswood Avenue, Chicago, Illinois, pursuant to written notice duly given to each director.

The following directors, constituting a majority of the whole board and a quorum were present:

Gardner Abbott
Max J. DeForest
Clarence R. Eichenberger
Richard H. Schaefer
Charles E. Schmidt, Jr.
Samuel P. Sharfman
Wesley V. Walker

The remaining directors, Blancke C. Noyes and George W. Sullivan, were absent. William G. Burns was present at the invitation of the board.

Gardner Abbott, Chairman of the Board, acted as chairman and Richard H. Schaefer kept the minutes of the meeting.

On motion duly made, seconded and unanimously carried, a reading of the minutes of the meeting of the board held December 20, 1968, was waived and such minutes were approved.

The chairman presented the resignation of Charles E. Schmidt as a director, effective January 31, 1969. Upon motion made,

seconded and unanimously carried, the following resolution was adopted:

> RESOLVED that the resignation of Charles E. Schmidt as a director, effective January 31, 1969, is accepted, and the corporation extends its appreciation to Mr. Schmidt for his services as a director.

The Chairman directed that Mr. Schmidt's resignation be filed in the corporation's minute book with the minutes of the meeting.

After discussion of proposed amendments of the stock bonus trust agreement of the corporation changing the times for certain distributions to terminated employees, and upon motion made, seconded and unanimously carried, the following resolution was adopted:

> RESOLVED, that the proper officers of the corporation be authorized to execute an amendment to the agreement creating the corporation's stock bonus trust, in substantially the form submitted to this meeting, such amendment to be effective as of November 1, 1968 and to provide that (1) a participant who resigns or is discharged shall be entitled to distribution of his vested interest in the trust as soon as practicable after the end of the fiscal quarter in which his resignation or discharge occurs, and (2) if his distribution date is other than October 31, his interest shall comprise the shares of stock and other assets credited to his account as of the preceding October 31 plus an amount of cash equal to the dividends paid with respect to such shares since that October 31.

There was a discussion of the need for postponing the annual meeting of stockholders noticed to be held on February 10, 1969, as a result of the sale by members of the Schmidt family of their shares in the corporation to National Industries, Inc. and the request of National Industries, Inc. that persons

named by it be included in the slate of nominees to be presented to the stockholders for election as directors.

After discussion and upon motion made, seconded and unanimously carried, the following resolutions were adopted:

> RESOLVED that the postponement of the annual meeting of stockholders of the corporation from February 10, 1969 to 11:00 o'clock a.m. March 31, 1969 (to be held in Room 1848, 135 South LaSalle Street, Chicago, Illinois 60603), is approved and that such postponement be recommended to the stockholders of the corporation at the annual meeting to be convened on February 10, 1969.
>
> FURTHER RESOLVED that the close of business on February 27, 1969 is fixed as the record date for the determination of stockholders of the corporation entitled to notice of and to vote at the adjourned annual meeting and at any further adjournment thereof.

There was a discussion of the request made by National Industries, Inc. for submission to the stockholders of nominees proposed by National Industries, Inc. During the course of the discussion, Mr. Abbott advised the board that he would not be a nominee for election as a director. After discussion and upon motion made, seconded and unanimously carried, the following resolutions were adopted:

> RESOLVED that at the adjourned annual meeting of stockholders there shall be submitted as nominees for election as directors the following persons previously selected as nominees for election as directors of the corporation:
>
> Max J. DeForest
> Richard H. Schaefer
> Samuel P. Sharfman
> Carl W. Sharfman
> Blancke Noyes
> Orville E. Peterson

and such of the following persons proposed by National Industries, Inc. as after further checking by the officers of the corporation appear to be acceptable and available as nominees:

Charles F. Simonelli
Allen [Allan] B. Solomon
Norman A. Stepelton
Hyman Ullner
Stanley R. Yarmuth

RESOLVED FURTHER that the solicitation by the management of the corporation of proxies to be voted at the adjourned annual meeting of stockholders is authorized, and Gardner Abbott, Samuel P. Sharfman and Richard H. Schaefer (each with full power of substitution) are constituted the management's proxy committee to act as the attorneys-in-fact for stockholders who furnish their proxies to the management for the adjourned meeting.

RESOLVED FURTHER that the officers of the corporation are authorized and directed on behalf of management to cause to be prepared a notice of the adjourned meeting. a revised proxy statement and form of proxy conforming to the rules of the Securities and Exchange Commission under the Securities Act of 1934 and to solicit proxies from the stockholders to be voted at the adjourned annual meeting for the election of the nominees identified in the second preceding resolution, upon the stock option plan of the corporation, and upon any other matters which may come before the meeting.

RESOLVED FURTHER that the secretary of the corporation shall cause to be mailed to each stockholder of record on the record date for the adjourned annual meeting and, to the extent appropriate, to such brokerage offices and other custodians, nominees of fiduciaries as in the judgment of the secretary may be interested in receiving such

material, the notice of the adjourned meeting and revised proxy statement and form of proxy.

RESOLVED FURTHER, that the cost of soliciting proxies in accordance with these resolutions, including expense of brokerage offices, custodians, nominees and fiduciaries in forwarding revised proxy material to the beneficial owners of stock held of record by such persons shall be paid by the corporation.

RESOLVED FURTHER that, if it is deemed necessary by the Chairman of the Board, President or Secretary of the corporation, directors, officers and regular employees of the corporation may, without additional compensation, make personal efforts to obtain proxies on behalf of the management.

After discussion and upon motion made, seconded and unanimously carried, the following resolution was adopted:

RESOLVED, that the number of directors constituting the whole board of directors is hereby reduced from 12 to 9, effective immediately, and the number of directors constituting the whole board of directors shall be increased, without further action by the board, from 9 to the total number of directors elected at the adjourned annual meeting of stockholders to be held March 31, 1969, or any adjournment thereof, effective immediately prior to such election.

As the next order of business, the board discussed dividend action, and upon motion duly made, seconded and unanimously carried, the following resolutions were adopted:

RESOLVED that a dividend of 15 cents on each share of common stock, $1 par value, of the corporation outstanding at the close of business on March 3, 1969, is hereby declared, payable on March 17, 1969 to holders of record at the close of business on March 3, 1969.

FURTHER RESOLVED that a dividend of 17½ cents on each share of $.70 cumulative convertible stock (preferred as to dividends), series 1, of the corporation outstanding at the close of business on April 16, 1969 (being the regular quarterly portion of the annual dividend rate of $.70 per share applicable to the period from February 1, 1969 to the close of business on April 30, 1969) is hereby declared, payable May 1, 1969 to holders of record at the close of business on April 16, 1969.

There was a discussion of the desirability of proceeding with plans to sell additional shares of common stock by the corporation, notwithstanding the withdrawal from the pending registration statement of shares of common stock intended to be sold by Charles E. Schmidt and his wife. At the conclusion of the discussion and upon motion made, seconded and unanimously carried, the following resolution was adopted:

RESOLVED that the authority relating to a public offering of common stock of the corporation granted by the Board of Directors in resolutions adopted at the special meeting of the Board of Directors held on December 20, 1968 is extended to cover, with respect to a total of 150,000 shares of common stock to be sold by the corporation in such public offering, (1) the filing with the Securities and Exchange Commission of a registration statement and amendments thereto covering shares of common stock of the corporation, (2) the negotiation of an underwriting agreement, (3) the taking of action under blue sky laws, (4) the filing of an application for listing of additional shares of common stock of the corporation on the New York Stock Exchange, and (5) the extension of the authority of the transfer agents and registrars for shares of the corporation, regardless of whether or not any shares of any shareholder of the corporation are also included in such offering.

Mr. Schaefer reported on sales, earnings and prospects of the Tractor Supply Division, and Mr. Sharfman made a similar report with respect to the Community Discount Division.

Mr. Schaefer summarized negotiations conducted by him on behalf of the corporation for the acquisition of all of the stock of Wikomi Manufacturing Co. for a maximum of 57,000 shares of common stock of the corporation, and after discussion and upon motion made, seconded and unanimously carried, the officers of the corporation were authorized to continue such negotiations and in their discretion to enter into an agreement for the acquisition of the stock of Wikomi for a consideration not to exceed 57,000 shares of common stock of the corporation.

There being no further business to come before the meeting, upon motion duly made, seconded and unanimously carried, the meeting was adjourned.

/s/ RICHARD H. SCHAEFER
Secretary of the meeting

Approved:
/s/ GARDNER ABBOTT
Chairman of the meeting

DEPOSITION EXHIBIT 23:

TSC INDUSTRIES, INC.

MINUTES OF ADJOURNED ANNUAL MEETING OF STOCKHOLDERS

March 31, 1969

The adjourned annual meeting of the stockholders of TSC Industries, Inc., a Delaware corporation, was held in Room 1848, Field Building, 135 South La Salle Street, Chicago, Illinois on Monday, March 31, 1969 at 11:00 a.m., pursuant to notice given in accordance with the bylaws of the corporation.

Gardner Abbott, chairman of the board of directors, presided and Lawrence W. Schweik, secretary of the corporation, acted as secretary of the meeting.

The chairman called the meeting to order and announced that the meeting was called to elect directors, to consider and vote upon approval of a proposed stock option plan for key employees and to transact such other business as might properly come before the meeting, and stated that the close of business on February 27, 1969 had been fixed as the record date for the determination of stockholders entitled to notice of and to vote at the meeting.

The secretary presented a complete list of all stockholders of record as of the close of business on February 27, 1969, stating that the list had been certified by The First National Bank of Chicago, and that the list had been kept at the office of the corporation, open to the examination of any stockholder during ordinary business hours, for a period of more than ten days prior to the meeting and that it would be available for examination by any stockholder during the meeting.

The secretary then presented the certificate of The First National Bank of Chicago evidencing the mailing on March 8, 1969 to each stockholder of record as of the close of business on February 27, 1969 of the notice of the meeting and a related proxy statement and form of proxy and the certificate of Thomas James, an employee of the company, certifying that the 1968 annual report was mailed prior to March 7, 1969 to all parties who became stockholders of record between January 3, 1969 and February 27, 1969. The secretary stated that the 1968 annual report had been previously mailed to all stockholders of record on January 3, 1969.

The chairman directed the secretary to file the certificates with the minutes of the meeting.

The secretary reported that the company had outstanding on February 27, 1969, 1,644,778 common shares and 988,614 preferred shares, 1,316,697 shares being required to constitute a quorum and that 1,209,131 common shares and 717,376 preferred shares were represented at the meeting, making a total of 1,926,507 shares represented at the meeting. Thereupon, the chairman announced that regular notice of the meeting having been given and a quorum being present, the meeting was regularly and lawfully convened and ready to transact business.

The chairman asked if any stockholders desired a reading of the minutes of the last meeting of stockholders, and there being no such request, upon motion duly made, seconded and unanimously carried, the reading of the minutes of the last meeting of stockholders was waived.

The meeting then proceeded to the election of ten directors. The following were nominated as directors to serve as provided by the bylaws:

Samuel P. Sharfman	Carl W. Sharfman
Richard H. Schaefer	Charles F. Simonelli
Max J. DeForest	Allan B. Solomon
Blancke Noyes	Hyman Ullner
Orville E. Peterson	Stanley R. Yarmuth

There being no other nominations, upon motion duly made, seconded and unanimously carried, the nominations were closed. The chairman introduced each of the nominees except Mr. Ullner who was not present.

A vote by ballot was then taken on the election of directors and the secretary recorded the vote and reported that the holders of 715,461 preferred shares and of 1,203,266 common shares or a total of 1,918,727 shares of both classes had voted in favor of the nominees. The chairman thereupon announced that the nominees had been elected directors of the corporation to serve until the next annual meeting of stockholders or until their successors were duly elected and qualified.

The meeting then proceeded to consideration of the stock option plan for key employees. The chairman announced that the plan had been adopted by the board of directors subject to the approval by the stockholders and that a copy of the plan was attached as an exhibit to the proxy statement forwarded to each stockholder entitled to vote at the meeting. Thereupon, it was moved and seconded that the following resolution be adopted:

> RESOLVED that the stockholders of TSC Industries, Inc., a Delaware corporation, approve the stock option plan for key employees of TSC Industries, Inc. submitted to this meeting, being the plan adopted by the board of directors on September 24, 1968 and appearing as Exhibit "A" to the proxy statement of TSC Industries, Inc. relating to this annual meeting of stockholders.

The chairman announced that the meeting was open to discussion on the motion. There being no discussion, a vote by ballot was taken and the secretary recorded the vote and reported that the holders of 1,187,166 common shares and 708,189 preferred shares or a total of 1,895,355 shares voted in favor of the motion to approve the stock option plan and the holders of 21,975 common shares and 9,187 preferred shares

or a total of 31,162 voted against the motion. The chairman thereupon declared that the motion having received the favorable vote of the holders of the majority of the outstanding shares had been approved and the resolution had been adopted.

The meeting then proceeded to consideration of the time and place for the first meeting of the newly elected board. On motion duly made and seconded, the following resolution was unanimously adopted:

> RESOLVED that the first meeting of the newly elected board of directors take place immediately following the adjournment of this annual meeting at the La Salle Hotel, Chicago, Illinois.

Mr. Abbott, Mr. Schaefer, Mr. Yarmuth and Mr. S. Sharfman then answered several questions put to them by stockholders from the floor.

No other business coming before the meeting, on motion duly made, seconded and carried, the meeting was adjourned at 11:40 o'clock a.m.

/s/ LAWRENCE W. SCHWEIK,
Secretary.

DEPOSITION EXHIBIT 26:

TSC INDUSTRIES, INC.

BOARD OF DIRECTORS ANNUAL MEETING
March 31, 1969

The 1969 annual meeting was held on Monday, March 31, 1969 immediately following the adjourned annual meeting of stockholders at the LaSalle Hotel, Chicago, Illinois.

The following directors were present:

Samuel P. Sharfman	Carl W. Sharfman
Richard H. Schaefer	Charles F. Simonelli
Max J. DeForest	Allan B. Solomon
Blancke Noyes	Stanley R. Yarmuth
Orville E. Peterson	

The remaining director, Hyman Ullner, was absent. Jack H. Segell, Lawrence W. Schweik and Thomas W. James were also present.

Mr. Yarmuth acted as chairman and Mr. Schweik acted as secretary.

The first order of business was the election of officers. On motion duly made and seconded, the following resolution was unanimously carried:

> RESOLVED that the following are elected officers of the corporation to serve until the next annual meeting of the Board of Directors or until the earlier removal from office of any of them:

Chairman of the Board	Stanley R. Yarmuth
Vice Chairman	Samuel P. Sharfman
President	Richard H. Schaefer
Vice President	Fred Colvin, Jr.

Vice President	Carl W. Sharfman
Treasurer	Dennis A. Bastas
Secretary	Lawrence W. Schweik
Assistant Secretary	Thomas W. James

Mr. Yarmuth, as chairman of the board and pursuant to the bylaws of the corporation, directed that in the absence of the chairman of the board the vice chairman shall perform the duties of the chairman of the board and that the president shall be the chief administrative officer of the corporation and shall consolidate and administer the operations of the corporation.

Thereafter the directors, on motion duly made and seconded, unanimously adopted the following resolution:

> RESOLVED that the corporation extends its appreciation to the previous Board of Directors for its services and that a plaque, appropriately embossed, be given to Mr. Abbott, former chairman of the board, in recognition of his thirty years of service to the corporation.

The board then reviewed the powers and limitations of the Executive Committee, and on motion duly made and seconded, the following resolution was unanimously adopted:

> RESOLVED that Stanley R. Yarmuth, Charles F. Simonelli, Blancke Noyes, Samuel P. Sharfman and Richard H. Schaefer are designated the Executive Committee of the Board of Directors of TSC Industries, Inc. to serve until directed otherwise by the Board of Directors, and that the Executive Committee shall have and may exercise the powers of the Board of Directors in the management of the business and affairs of the corporation and may authorize the seal of the corporation to be affixed to all papers which may require it, except the Executive Committee shall not have the powers of the Board with respect to:
>
> (a) Amending the certificate of incorporation of the corporation;

(b) Amending or repealing the bylaws of the corporation;

(c) Approving an agreement of merger or consolidation of the corporation with or into any other entity;

(d) Approving a sale or other transfer of all or substantially all the assets of the corporation;

(e) Approving a dissolution of the corporation;

(f) Electing or removing officers of the corporation or members of the executive committee;

(g) Fixing compensation payable by the corporation to any member of the Executive Committee; or

(h) Declaring dividends.

FURTHER RESOLVED that the members of the Executive Committee shall not have the right to appoint a substitute for an absent or disqualified member; that no meeting of the Executive Committee shall be valid unless all members are present at the meeting or waive notice thereof in writing either before or after the meeting; that three members shall constitute a quorum for the transaction of business; and that the concurring vote of not less than three members shall be required for any action of the executive committee.

The directors recommended that Mr. S. Sharfman and Mr. Schaefer study the powers and limitations vested in the Executive Committee and develop recommendations for amending the powers of the Executive Committee to be presented to the board for its consideration.

Mr. Schaefer informed the board of the need for a proxy and attorney-in-fact for the purpose of voting shares of stock held by the corporation in any of its subsidiaries. On motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED that Charles F. Simonelli is designated and appointed proxy and attorney-in-fact of the corporation to vote the shares of stock held by the corporation in any of its subsidiaries.

The next order of business was consideration of directors' fees. Further discussion was deferred to the board's next meeting.

Thereafter, the board discussed the need for a general banking resolution and on motion duly made and seconded, it adopted the following resolution:

RESOLVED that any two of the following officers of the corporation, the vice chairman, president or treasurer, are authorized in the regular course of business to open accounts with such banks as such officers shall select to carry on the business of the corporation and to file all signature cards, consents, security bonds and other documents and to take such other action as they may consider necessary or advisable to open and maintain the accounts.

FURTHER RESOLVED that such officers are authorized to designate employees of the corporation to act for the corporation in connection with any such account, including but not limited to, the signing of checks.

The directors expressed an intention that the corporation's subsidiaries adopt resolutions granting authorities to appropriate officers, such as in the foregoing banking resolutions, so that the operating procedures of the subsidiaries will be consistent with those of the corporation.

The board then considered the designation of certain officers to act for the corporation in the regular and ordinary course of its business and decided that this matter would be given further consideration at the next meeting and it was recommended that Mr. S. Sharfman and Mr. Schaefer develop recommendations as to the granting of such authority.

Thereafter, after discussion on motion duly made, the following resolution was adopted:

> RESOLVED that regular meetings of the Board of Directors shall be held on the fourth Monday of each month at the offices of the corporation, 4747 North Ravenswood Avenue, Chicago, Illinois at 2:00 P.M. and that the Executive Committee shall meet at 12:00 noon on the same day and at the same location and that written notice of all such meetings shall be given.

There being no further business to come before the meeting, on motion duly made and seconded, the meeting was adjourned.

/s/ LAWRENCE W. SCHWEIK,
Secretary.

DEPOSITION EXHIBIT 43:

TSC INDUSTRIES, INC. EXECUTIVE COMMITTEE MEETING

March 31, 1969

Present
Stanley R. Yarmuth
Samuel Sharfman
Richard Schaefer
Blancke Noyes
Charles F. Simonelli, Chairman

A discussion of the current and proposed salary structure of TSC INDUSTRIES, INC. was the only subject on the agenda.

The Executive Committee approved the following compensation for key personnel:

R. Schaefer—President and Chief Administrative Officer TSC INDUSTRIES, INC. $40,000 current to $50,000 per annum.

S. Sharfman—Vice Chairman of the Board of TSC INDUSTRIES, INC. and President of COMMUNITY DISCOUNT CENTERS, INC. $65,000 current income—$22,500 deferred income Total $87,500 per annum.

C. Sharfman—Vice President of TSC INDUSTRIES, INC. and Vice President of COMMUNITY DISCOUNT CENTERS, INC. $35,000 current income—$15,000 deferred income Total $50,000 per annum.

F. Colvin—Vice President—TSC INDUSTRIES, INC. $25,000 current to $30,000 per annum.

D. Bastas—Treasurer—TSC INDUSTRIES, INC. $20,000 current to $25,000 per annum.

L. Schweik—Secretary—TSC INDUSTRIES, INC. $16,500 current to $18,500 per annum.

T. James—Assistant Secretary—TSC INDUSTRIES, INC. $17,000 per annum—no change.

M. DeForest—Vice President—Operations, TRACTOR DIVISION $23,000 current to $25,000 per annum.

D. Lazar—Vice President—Advertising and Promotion COMMUNITY DISCOUNT CENTERS, INC. $30,000 per annum—no change.

B. Simmon—Vice President—Finance COMMUNITY DISCOUNT CENTERS, INC. $30,000 per annum—no change.

/s/ CHARLES F. SIMONELLI,
Charles F. Simonelli.

DEPOSITION EXHIBIT 49:

National Industries, Inc. Form Schedule 13D, Filed with Securities Exchange Commission,

February 14, 1969.

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SCHEDULE 13D

Filed By

NATIONAL INDUSTRIES, INC.
(A Kentucky Corporation)

510 West Broadway

Louisville, Kentucky

Item 1. *Security and Issuer*

This statement relates to the Comon Stock, par value $1.00 per share and the $.70 Cumulative Convertible Preferred Stock, par value $1.00 per share of TSC Industries, Inc. ("TSC"), 4747 North Ravenswood, Chicago, Illinois.

Item 2. *Identity and Background*

National Industries, Inc. ("National"), 510 West Broadway, Louisville, Kentucky, is a diversified company engaged in various businesses through subsidiary corporations. Its principal business activities include the operation of popular priced department stores, the manufacture and sale of carbonated beverages and flavor concentrates, the production and marketing of food and dairy products, the manufacture and sale of laboratory furniture and equipment, the production, refining and distribution of petroleum products and the writing of fire and casualty insurance.

The names, business and residence addresses of the Directors, officers and controlling stockholders of National, their present principal occupations and their material occupations during the past ten years, are as follows:

[1] Name	—Joseph A. Gammon
Business Address	—510 West Broadway, Louisville, Kentucky
Residence	—3074 Beals Branch Road Louisville, Kentucky
Present Occupation	—Vice President, Transportation & Director National Industries, Inc.
Place of Business	—510 West Broadway Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position	—President & Executive Vice President
Organization	—Louisville Taxicab and Transfer Co.
Address	—832 West Liberty Louisville, Kentucky
Dates Pos. Held	—President—March 1964—December 1967 Executive Vice President—March 1962—March 1964
Position	—President, Vice President & Director
Organization	—Southern Tank Lines, Inc.
Address	—4107 Bells Lane Louisville, Kentucky
Dates Pos. Held	—Vice President—December 1953—October 1960 President—October 1960—to date Director—March 1954—to date
Position	—Vice President Transportation & Director
Organization	—National Industries, Inc.
Address	—510 West Broadway Louisville, Kentucky
Dates Pos. Held	—Vice President—Transportation—September 1966—to date Director—May 1967—to date

Position	—Director
Organization	—South Atlantic Co.
Address	—Tampa, Florida
Dates Pos. Held	—March 1963—to date
Position	—President
Organization	—Southern Cab Corporation
Address	—510 West Broadway Louisville, Kentucky
Dates Pos. Held	—May 1960—to date
Position	—Director
Organization	—Southern Union Life Insurance Co.
Address	—Dallas, Texas
Dates Pos. Held	—1964
Position	—Executive Vice President & Director
Organization	—Atlanta Taxicabs, Inc.
Address	—Atlanta, Georgia
Dates Pos. Held	—July 1962—April 1965

[2] Name	—Allan B. Solomon
Business Address	—510 West Broadway, Louisville, Kentucky
Residence	—1403 Community Way Louisville, Kentucky
Present Occupation	—Vice President Corporate Planning & Development National Industries, Inc.
Place of Business	—510 West Broadway Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position	—Associate
Organization	—Greenebaum, Barnett, Doll & Matthews—Attorneys at Law
Address	—Suite 614, Kentucky Home Life Building Louisville, Kentucky
Dates Pos. Held	—September 1961—March 1964
Position	—Assistant Secretary, Vice President—Legal, Vice President Corporate Planning & Development

Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —Assistant Secretary—March 1964—to date
Vice President—Legal—April 1965—June 1968
Vice President—Corporate Planning & Development—June 1968—to date.

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[3] Name —Gerald H. Weinstein
Business Address —510 West Broadway, Louisville, Kentucky
Residence —3003 Shallcross Way
Louisville, Kentucky

Present Occupation—Secretary & Counsel, National Industries, Inc.
Place of Business —510 West Broadway
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Associate
Organization —Bond, Scholneck & King, Attorneys at Law
Address —Syracuse, New York
Dates Pos. Held —January 1958—August 1967

Position —Secretary & Counsel
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —November 1967—to date

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[4] Name —Bernard H. Barnett
Business Address —510 West Broadway, Louisville, Kentucky
Residence —200 Millvale Road
Louisville, Kentucky

Present Occupation—Attorney
Place of Business —Greenebaum, Barnett, Doll & Matthews, Attorneys at Law
Address —Suite 614, Kentucky Home Life Building
241 S. 5th Street
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Partner
Organization —Law firm of Greenebaum, Barnett, Doll & Matthews
Address —Suite 614, Kentucky Home Life Building
241 S. 5th Street
Louisville, Kentucky
Dates Pos. Held —April 1952—to date

Position —Director & Chairman of the Board
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —Director since 1964
Chairman of the Board since September, 1964

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[5] Name —Roger Elton
Business Address —410 Madison Avenue
New York, New York
Residence —17 Eastland Drive
Glen Cove, New York

Present Occupation—President, National Division, Franklin National Bank
Place of Business —401 Madison Avenue
New York, New York

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Director
Organization —Housatanic Public Service Co., Inc.
Address —Bethel, Connecticut
Dates Pos. Held —1956-1961

Position —Director
Organization —Acme-Hamilton Manufacturing Co.
Address —Trenton, New Jersey
Dates Pos. Held —1957-1961

Position —Senior Vice President
Organization —Manufacturers Hanover Trust Company

Address —350 Park Avenue
New York, New York
Dates Pos. Held —June 1959-October 1962
Position —Executive Vice President &
President-National Division
Organization —Franklin National Bank
Address —410 Madison Avenue
New York, New York
Dates Pos. Held —Executive Vice President—
October 1962-June 1964
President-National Division—
June 1964-to date

Position —Director
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —June 1968-to date

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[6] Name —Grant Thomas
Business Address —4500 Camp Ground Road
Louisville, Kentucky
Residence —1800 Knollwood Road
Louisville, Kentucky
Present Occupation—President,
American Synthetic Rubber Corp.
Place of Business —4500 Camp Ground Road
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —President & Director
Organization —American Synthetic Rubber Corp.
Address —4500 Camp Ground Road
Louisville, Kentucky
Dates Pos. Held —August 1958-to date

Position —Director
Organization —Bank of Louisville
Address —500 West Broadway
Louisville, Kentucky
Dates Pos. Held —August 1963-to date

Position —Director
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —November 1963-to date

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[7] Name —J. Howard Marshall
Business Address —1320 Esperson Building, Houston, Texas
Residence —11206 Tynewood Drive
Houston, Texas
Present Occupation—Petroleum Consultant & Independent Oil & Gas Operator
Place of Business —1320 Esperson Building
Houston, Texas

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Executive Vice President & Director
Organization —Signal Oil & Gas Co.
Address —Los Angeles, California
Dates Pos. Held —1959-1960

Position —President & Chief Executive Officer
Organization —Union Texas Natural Gas Corp.,
Division of Allied Chemical Corp.
Address —Houston, Texas
Dates Pos. Held —1961-1962

Position —Director & Executive Vice President
Organization —Allied Chemical Corporation
Address —61 Broadway
New York, New York
Dates Pos. Held —1962-to date Director
1965-1967 Executive Vice President

Position —Director
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —April 1965-August 1965
May 1966-present

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[8] Name —John J. Cott
Business Address —197 Chatham Street,
New Haven, Connecticut
Residence —20 Old Mamaroneck Road
White Plains, New York

Present Occupation—President—Cott Corporation
Place of Business —197 Chatham Street
New Haven, Connecticut

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Director and President
Organization —Cott Corporation
Address —197 Chatham Street
New Haven, Connecticut
Dates Pos. Held —Director since March 1950
President since April 1955

Position —Director
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —June 1968-to date

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[9] Name —Joseph A. Henehan, Jr.
Business Address —510 West Broadway, Louisville, Kentucky
Residence —3015 Bunker Hill Drive
Louisville, Kentucky

Present Occupation—Controller, National Industries, Inc.
Place of Business —510 West Broadway
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Supervisor
Organization —Ernst & Ernst
Address —1700 Commonwealth Building
Louisville, Kentucky
Dates Pos. Held —July 1957-December 1967

Position —Controller
Organization —National Industries, Inc.

Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —December 1967-to date

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[10] Name —Jerome H. Simons
Business Address —Suite 200
221 North LaSalle Street
Chicago, Ilinois
Residence —7236 Lowell Avenue
Lincolnwood, Illinois

Present Occupation—Vice President, National Industries, Inc.
Place of Business —Suite 200
221 North LaSalle Street
Chicago, Illinois

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Vice President & General Counsel
Organization —Apple-Cole Company of Chicago,
Financial Consultants
Address —53 W. Jackson Boulevard
Chicago, Illinois
Dates Pos. Held —September 1958-June 1966

Position —Manager of Mergers & Acquisitions
Division
Organization —Exchange National Bank of Chicago
Address —LaSalle & Adams Streets
Chicago, Illinois
Dates Pos. Held —June 1966-February 1968

Position —Vice President
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —February 1968-to date

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[11] Name —Seymour B. Orner
Business Address —221 North LaSalle Street, Chicago, Illinois
Residence —146 Pine Point Drive
Highland Park, Illinois

Present Occupation—Vice President, National Industries, Inc.
Chairman of the Board—
LaSalle National Insurance Company

Place of Business —221 North LaSalle Street
Chicago, Illinois

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —President, Chairman of the Board
Organization —LaSalle National Insurance Company
Address —221 North LaSalle Street
Chicago, Illinois
Dates Pos. Held —November 1949-to date

Position —Vice President
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —April 1965-to date

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[12] Name —James F. Breuil, Sr.
Business Address —100 Park Ave. Building
Oklahoma City, Oklahoma 73116
Residence —9 Indian Creek Island
Indian Creek Village
North Miami Beach, Florida 31154
Present Occupation—Petroleum Consultant
Place of Business —100 Park Ave. Building
Oklahoma City, Oklahoma

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —President & Director
Organization —Kingwood Oil Company
Address —100 Park Ave. Building
Oklahoma City, Oklahoma
Dates Pos. Held —March 1950-September 1965

Position —Director
Organization —Ashland Oil Company
Address —Box 391
Ashland, Kentucky
Dates Pos. Held —May 1950-to date

Position —Director
Organization —National Industries, Inc.

Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —April 1965-to date

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[13] Name —Donald G. McClinton
Business Address —510 West Broadway
Louisville, Kentucky
Residence —3603 Sorrento Avenue
Louisville, Kentucky
Present Occupation—Vice President, Financial,
National Industries, Inc.
Place of Business —510 West Broadway
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Manager
Organization —Arthur Anderson & Co.
Address —1717 East 9th Street
Cleveland, Ohio
Dates Pos. Held —June 1955-December 1962

Position —Manager—Accounting
Organization —East Ohio Gas Co.
Address —Cleveland, Ohio
Dates Pos. Held —December 1962-January 1966

Position —Vice President—Financial
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —February 1966-to date

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[14] Name —Carles F. Simonelli
Business Address —510 West Broadway, Louisville, Kentucky
Residence —5812 Orion Road
Louisville, Kentucky
Present Occupation—Executive Vice President,
National Industries, Inc.
Place of Business —510 West Broadway
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Assistant to the President
Organization —Universal Picture Co., Inc.
Address —100 Universal Plaza
Universal City, California
Dates Pos. Held —November 1959-November 1962

Position —Vice President
Organization —Television Industries, Inc.
Address —Park Avenue
New York, New York
Dates Pos. Held —November 1962-April 1963

Position —Vice President, Executive Vice President, Director
Organization —Technicolor, Inc.
Address —6311 Romaine Street
Hollywood, California
Dates Pos. Held —Vice President—April 1963-May 1966
Executive Vice President— May 1966-January 1968
Director—December 1965-January 1968

Position —Executive Vice President
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —September 1968—to date

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[15] Name —Alvin H. Einbender
Business Address —270 Park Avenue, New York, New York
Residence —No. 3 Sherbrooke Road
Scarsdale, New York

Present Occupation—Chairman of the Board, Retail Centers of the Americas, Inc.
Place of Business —605 Rockaway Turnpike
Lawrence, Long Island, New York

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Legal Counsel, President
Organization —Gem International

Address —St. Louis, Missouri
Dates Pos. Held —1958-February 1960

Position —President
Organization —G*E*S Stores, Inc.
Address —Kentucky Home Life Building
Louisville, Kentucky
Dates Pos. Held —February 1960-June 1964

Position —Chairman of the Board
Organization —Retail Centers of the Americas, Inc.
Address —605 Rockaway Turnpike
Lawrence, Long Island, New York
Dates Pos. Held —October 1964 to date

Position —Executive Vice President, Chairman of the Executive Committee
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —September 1964-Sept. 1968 Executive Vice President
September 1968-to date Chairman of the Executive Committee

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[16] Name —Stanley R. Yarmuth
Business Address —510 West Broadway, Louisville, Kentucky
Residence —3609 Glenview Road
Glenview, Kentucky

Present Occupation—President & Director of National Industries, Inc.
Place of Business —510 West Broadway
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —President & Director
Organization —National Auto Sales, Inc.
Address —815 West Broadway
Louisville, Kentucky
Dates Pos. Held —April 1957-May 1963

Position —President & Director
Organization —National Industries, Inc.

Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —May 1963-to date

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[17] Name —Ralph M. Cronin
Business Address —510 West Broadway, Louisville, Kentucky
Residence —2352 Village Drive
Louisville, Kentucky

Present Occupation—Vice President, Corporate Communications, National Industries
Place of Business —510 West Broadway
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Vice President-Special Sales
Organization —Keller-Crescent Company, Advertising Specialists
Address —Evansville, Indiana
Dates Pos. Held —June 1947-September 1964

Position —Vice President, Corporate Communications
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —Since September 1964

Position —Director
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —Since April 1965

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[18] Name —Reginald P. Trubey
Business Address —510 West Broadway, Louisville, Kentucky
Residence —10806 Ward Avenue
Anchorage, Kentucky

Present Occupation—Vice President, National Industries, Inc.
Place of Business —510 West Broadway
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Partner
Organization —Rex Trubey & Associates, Business Brokers
Address —c/o Orville Rush
Washington Building
Washington, D. C.
Dates Pos. Held —January 1959-January 1960

Position —Director of Industrial Development
Organization —Chamber of Commerce
Address —300 West Liberty
Louisville, Kentucky
Dates Pos. Held —January 1960-July 1962

Position —Partner
Organization —Rex Trubey & Associates, Business Brokers
Address —Washington Building
Louisville, Kentucky
Dates Pos. Held —January 1962-May 1963

Position —Vice President
Organization —National Industries, Inc.
Address —510 West Broadway
Louisville, Kentucky
Dates Pos. Held —Since May 1963

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[19] Name —Ivan Greenspan
Business Address —510 West Broadway, Louisville, Kentucky
Residence —1608 Dunbarton Wynde
Louisville, Kentucky

Present Occupation—Vice President & Treasurer, National Industries, Inc.
Place of Business —510 West Broadway
Louisville, Kentucky

Material Positions Held During the Last Ten Years; Dates; Addresses

Position —Senior Accountant
Organization —Welenken & Master, Certified Public Accountants

Address	—Hoffman Building 4th & Market Streets Louisville, Kentucky
Dates Pos. Held	—November 1955-October 1960
Position	—Treasurer
Organization	—National Auto Sales, Inc.
Address	—801 West Broadway Louisville, Kentucky
Dates Pos. Held	—October 1960-May 1963
Position	—Treasurer
Organization	—National Industries, Inc.
Address	—510 West Broadway Louisville, Kentucky
Dates Pos. Held	—Since May 1963
Position	—Vice President
Organization	—National Industries, Inc.
Address	—510 West Broadway Louisville, Kentucky
Dates Pos. Held	—Since June 1968
Position	—Secretary
Organization	—National Industries, Inc.
Address	—510 West Broadway Louisville, Kentucky
Dates Pos. Held	—May 1963-June 1968

Neither National nor any of the above-named persons have, during the past ten years, been convicted in a criminal proceeding (excluding traffic violation or other similar misdemeanors).

Item 3. Source and Amount of Funds or Other Consideration

National has purchased (i) 434,682 shares of TSC Common Stock for cash and five percent face amount notes totaling $13,040,460 and (ii) 439,675 shares of TSC $.70 Cumulative Convertible Preferred Stock for cash and five percent face amount notes totaling $9,892,687.50. In addition, National transferred to the selling shareholders warrants to purchase an

aggregate of 125,000 shares of National Common Stock. The total consideration was or is to be paid or delivered as follows:

(a) On February 7, 1969, the Closing Date, National paid cash to the selling shareholders in the aggregate amount of $5,733,286.88.

(b) On February 7, 1969, National delivered to the selling shareholders National's promissory notes evidencing the balance of the purchase price in the aggregate face amount of $17,199,860.62. The notes are payable in six annual installments of principal and interest commencing one year after the closing, except that the first interest payment is due nine months after the closing date. The first five payments will be in an amount equal to ten percent of the total price due each seller with the sixth installment consisting of the balance of the purchase price. Interest is payable on the notes at the rate of five percent per annum from the closing date.

(c) On February 7, 1969, National delivered to the selling shareholders warrants granting them the right to purchase an aggregate of 125,000 shares of National Common Stock at a price of $24.00 per share. These warrants contain certain antidilution provisions and are exercisable for a period of one year commencing February 7, 1974 and ending on February 6, 1975.

National has also paid $211,349.00 to Henderson, O'Reilly & Co., a business broker, as a finder's fee and commission in connection with the purchase of the securities described herein.

National used its general corporate funds in the amount of $5,733,286.88 to make the initial payment for the securities described herein. These funds were derived from the public sale by National of $25,000,000 principal amount 5¾% Convertible Subordinated Debentures in October of 1968.

National may pay the balance of the purchase price by the use of general corporate funds by intermediate or long-term

borrowing from banks or other financial institutions or the sale of National securities. At the present time, however, National has received no loan commitments, and National has no plans or arrangements for the sale of its securities or for other financing to pay promissory notes described herein.

Item 4. Purpose of Transaction

National has acquired approximately 33% of the outstanding voting shares of TSC., Inc. Accordingly, National may be deemed to be a "parent" of TSC as that term is defined in the Rules and Regulations under the Securities Act of 1933.

The TSC stock was purchased by National as an investment within the scope of National's overall business operations. Although National does not have any immediate plans or proposals to liquidate TSC, to sell its assets, or to merge it with National, or any other persons, or to make any other major change in its business or corporate structure, National may in the future acquire additional shares of TSC stock or propose any of the aforementioned courses of action.

National has designated five nominees of TSC management's proposed 11 man slate of directors for election at the Annual Meeting which has been deferred to March 31, 1969. National hopes to be able to participate in the management of TSC through its three executive officers who are nominees for election to the Board of Directors of TSC.

Item 5. Interest in Securities of the Issuer

National beneficially owns a total of 434,682 shares of TSC Common Stock, and 439,675 shares of the $.70 Cumulative Convertible Preferred Stock of TSC, which Preferred Stock is convertible into Common Stock at the rate of .75 common share for each preferred share. No associate of National beneficially owns or has a right to acquire directly or indirectly any of the securities described in Item 1 herein, and neither National nor its officers, directors and affiliated persons have effected any transactions in aforementioned securities during the past 60 days except as described herein.

Item 6. Contracts, Arrangements or Understandings with Respect to Securities of the Issuer

The securities described in Item 5 were purchased by National on February 7, 1969, pursuant to a stock purchase agreement dated January 30, 1969 and a supplementary agreement dated February 6, 1969 between National and the following selling shareholders who agreed to sell and did sell the number of TSC shares indicated below (constituting all of the shares owned by them) for the consideration disclosed in Item 3 above:

	Number of Shares of TSC Sold	
Sellers	Common Shares	$.70 Cumulative Preferred Shares
Charles E. Schmidt	414,545	338,874
Dorothy F. Schmidt	5,297	30,000
Richard L. Schmidt	6,000	30,001
Charles E. Schmidt, Jr.	1,000	40,700
Charles E. and Dorothy Schmidt Family Foundation	7,840	.....
Total	434,682	439,675

Each selling shareholder has delivered to National an irrevocable proxy to vote at any regular or special meeting of the stockholders of TSC, all of the shares of Common Stock and $.70 Cumulative Convertible Preferred Stock sold to National pursuant to the agreement. Each seller has also signed an investment letter to the effect that he is acquiring the promissory note payable to him, the warrant delivered to him, and any of the shares of common stock issued to him upon exercise of said warrant, for investment and not with a view to or for sale or other distribution; and that he will not publicly offer or sell the promissory note and/or warrant acquired or the shares of common stock issuable on exercise of the warrant in violation of the Securities Act of 1933, as amended. National has agreed that it will not sell or tranfer any of the shares of TSC purchased pursuant to the agreement, in violation of the Securities Act of 1933.

Pursuant to National's request to the Board of Directors and management of TSC for proper representation on the TSC Board of Directors, (i) the Annual Meeting scheduled for February 10, 1969 was adjourned to March 31, 1969, and (ii) the TSC Board of Directors agreed to include 5 designees of National on management's slate of 11 directors to be voted upon at the forthcoming meeting of shareholders. These designees are Stanley R. Yarmuth, President of National; Charles Simonelli, Executive Vice President of National; Allan B. Solomon, Vice President, Corporate Planning and Development of National; Hyman Ullner, President of Hyde Park Industries, Inc., Newport, Kentucky; and Norman Stapleton, President of National Tea Company, Chicago, Illinois.

Item 7. Persons Retained, Employed or to be Compensated

Not applicable.

Item 8. Material to be Filed as Exhibits

Not applicable.

Signature

I certify that to the best of my knowledge and belief the information set forth in this statement is true, complete and correct.

Date: 2-14-69 /s/ ALLAN B. SOLOMON

I, Allan B. Solomon, Vice President, Corporate Planning and Development, National Industries, Inc., hereby certify that National Industries, Inc. has caused this Schedule 13D to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Louisville and State of Kentucky, on the 14th day of February, 1969.

National Industires, Inc.
By /s/ ALLAN B. SOLOMON
Allan B. Solomon
Vice President, Corporate Planning and Development, National Industries, Inc.

DEPOSITION EXHIBIT 60

TSC Industries, Inc. Interim Report to the Stockholders, July 31, 1969

INTERIM REPORT

TO THE STOCKHOLDERS

TSC

TSC INDUSTRIES, INC.
and Its Subsidiaries

FOR QUARTER ENDING

JULY
31st
1969

September 22, 1969

Dear Stockholder:

The third quarter results are very unfavorable when compared to the like period of 1968. Difficulties with our Community Discount Division continued while the Farm Store Division results for the quarter and year to date continued strong, showing a 15% increase in net profit.

Sales for the third quarter ended July 31 were $48,551,728 up 8% from last year's $45,139,936. Net income for the quarter amounted to $163,761, compared to fiscal 1968 $1,180,445.

Sales for the nine months were $135,965,341 an increase of 12% over last year's $121,286,233. Net earnings for the nine months were $1,784,466 compared to fiscal 1968 $2,967,912.

Earnings per common share, assuming full dilution of issued and outstanding convertible stock were 7¢ per share for the third period and 72¢ for the nine months versus 49¢ and $1.24 for the corresponding periods of fiscal 1968.

While sales were not strong in the Community Discount Division, the third quarter's results cannot be wholly attributed to this fact. A careful review of our Community Discount Division has been made by your new management. The result of this study was the providing of reserves and taking of significant markdowns to bring the inventories into proper valuation in relation to conditions and quantities of merchandise on hand.

Furthermore, because of the close proximity of two of our major discount stores, we know that neither are profitable. We believe that we can improve our results in this Division by closing one store. Accordingly, we plan to close one of these stores in the next 60 days. Reserves have been provided to cover the one time losses which will be incurred in this closure.

Major management realignments have been made in the Discount Store Division. At this time, I feel that we can look forward to improvements in the Division over the next twelve months.

Sales and earnings in the Farm Store Division continued advancing strongly. There is little question that it will post significant increases for the year, resulting in its greatest year ever.

Currently, the Farm Store Division has seven new stores under construction while 18 relocations are in process. The relocation and modernization program started last year continues to indicate profit improvement and growth.

On July 7th TSC announced an agreement with Firestone Tire and Rubber Co. whereby Firestone will operate complete automotive sales and service centers in 6 Chicago area Community stores.

I have attempted to face all the problems head on and provide a base for future growth. Our management team is experienced and has been organized into well defined areas of responsibility with clear cut profit objectives. We are optimistic for the fourth quarter and especially for 1970.

Richard H. Schaefer
President

COMPARATIVE CONSOLIDATED STATEMENT OF INCOME

TSC INDUSTRIES, INC. AND ITS SUBSIDIARIES

	Three Months Ended July 31,		Nine Months Ended July 31,	
	1969	1968	1969	1968
Net Sales	$48,551,728	$45,139,936	$135,965,341	$121,286,233
Cost of Sales	37,219,591	33,356,826	102,212,521	89,874,872
Gross Profit	$11,332,137	$11,783,110	$ 33,752,820	$ 31,411,361
Operating Expenses	10,409,544	9,364,533	29,254,812	25,021,183
Net Income from Operations	$ 922,593	$ 2,418,577	$ 4,498,008	$ 6,390,178
Other Deductions—Net	593,832	56,132	948,542	488,266
Net Income, Before Provision for Federal Income Taxes and Extraordinary Item	$ 328,761	$ 2,362,445	$ 3,549,466	$ 5,901,912
Provision for Federal Income Taxes	165,000	1,182,000	1,765,000	2,934,000
Net Income Before Extraordinary Item	$ 163,761	$ 1,180,445	$ 1,784,466	$ 2,967,912
Extraordinary Item—Federal Income Tax Reduction from Carryover of Prior Years' Operating Losses	—	—	—	118,000
Net Income	$ 163,761	$ 1,180,445	$ 1,784,466	$ 3,085,912
Per Share Earnings				
Common and Common Equivalent Share Earnings				
Before Extraordinary Item	$ —	$ .69	$ .74	$ 1.66
Extraordinary Item	—	—	—	.09
Net Income	$ —	$ .69	$ .74	$ 1.75
Earnings per Common Share—assuming full dilution				
Before Extraordinary Item	$ .07	$ .49	$ .72	$ 1.24
Extraordinary Item	—	—	—	.05
Net Income	$ .07	$ .49	$ .72	$ 1.29

This statement was taken from the books of the companies without audit and is subject to year end audit adjustments.

(1) Common and common equivalent share earnings are based upon earnings applicable to the total of the average number of outstanding shares of common stock and shares of common stock which would be issuable upon the exercise of outstanding options to acquire common stock.

(2) Earnings per common share—assuming full dilution, give effect to the reduction in earnings per share which would result from the conversion of the $.70 cumulative convertible stock and the issuance (and subsequent conversion) of the $.70 cumulative convertible stock upon the exercise of outstanding options to acquire the $.70 cumulative convertible stock.

OFFICERS OF TSC INDUSTRIES, INC.

Chairman of the Board.....STANLEY R. YARMUTH
President.....RICHARD H. SCHAEFER
Vice President.....FRED COLVIN, JR.
Treasurer.....DENNIS A. BASTAS
Secretary.....LAWRENCE W. SCHWEIK
Assistant Secretary.....THOMAS W. JAMES

NEW FARM STORES UNDER CONSTRUCTION

Crawfordsville, Indiana
Plymouth, Indiana
Waverly, Iowa
Wilmer, Minnesota
Winona, Minnesota
Defiance, Ohio
Washington Court House, Ohio

TSC INDUSTRIES, INC.

4747 N. RAVENSWOOD AVE. • CHICAGO, ILLINOIS 60640

DEPOSITION EXHIBIT 169

Letter and Minutes, TSC Industries, Inc., Board of Directors, May 26, 1969

TSC Industries, Inc.
4747 North Ravenswood Avenue/Chicago, Illinois 60640/
Phone 312-334-7900

June 3, 1969

To All Directors:

Max J. DeForest	Samuel P. Sharfman
Blancke Noyes	Charles F. Simonelli
Orville E. Peterson	Allan B. Solomon
Richard H. Schaefer	Hyman Ullner
Carl W. Sharfman	Stanley R. Yarmuth

Enclosed is a copy of the minutes of the meeting held on May 26, 1969.

Cordially yours,

/s/ LAWRENCE W. SCHWEIK,
Lawrence W. Schweik,
Secretary.

LWS:cp
enc.

TSC INDUSTRIES, INC.

BOARD OF DIRECTORS MEETING

May 26, 1969

The regular monthly meeting of the Board of Directors of TSC Industries, Inc., a Delaware corporation, was held on Monday, May 26, 1969 at 2:00 p.m. at Room 200, LaSalle Insurance Company, 221 North LaSalle Street, Chicago, Illinois.

A quorum of directors was present as follows:

Max J. DeForest	Carl W. Sharfman
Blancke Noyes	Samuel P. Sharfman
Orville E. Peterson	Charles F. Simonelli
Richard H. Schaefer	

The remaining directors, Allan B. Solomon, Hyman Ullner and Stanley R. Yarmuth, were absent. Jack H. Segell and Lawrence W. Schweik were also present. Mr. S. Sharfman acted as chairman and Mr. Schweik acted as secretary.

All directors having previously been furnished with written copies of the minutes of the last meeting of the board held on April 28, 1969, on motion duly made, seconded and unanimously carried, a reading of said minutes was waived and the minutes were approved.

Mr. Schaefer reported on sales, earnings and prospects of the Tractor Division and Mr. S. Sharfman made a similar report with respect to the Community Division.

The directors considered an increase in the authorized number of directors. Thereupon, on motion duly made, seconded and unanimously carried, the following resolution was adopted:

> RESOLVED that the number of directors of the corporation is increased from ten to eleven.

The directors then considered filling such newly created directorship and upon motion duly made, seconded and unanimously carried, the following resolution was adopted:

> RESOLVED that Jack H. Segell is elected a director of the corporation, to hold office from May 26, 1969 until the next annual election and until his successor is elected and qualified, or until his earlier resignation or removal.

Mr. Segell reported on his visit to the Community Division Kansas City stores. There followed discussions of integrating the Community and Tractor merchandise lines and the Tractor Division's immediate plans for establishing new stores and relocating old stores. It was pointed out that at the Executive Committee meeting immediately preceding this board meeting, certain relocations and new stores had been approved. Thereupon on motion duly made, seconded and unanimously carried, the following resolution was adopted:

> RESOLVED that the action of the Executive Committee of the board of directors in approving the Tractor Division relocation of stores at Bloomington, Illinois, E. St. Louis, Illinois, Des Moines, Iowa, Evansville, Indiana, Lafayette, Indiana, and Nashville, Tennessee, and the establishment of new stores at Crawfordsville, Indiana, Defiance, Ohio, Kirksville, Missouri, Plymouth, Indiana, Washington Court House, Ohio,. Waverly, Iowa, Winona, Minnesota, and Valparaiso, Indiana, is hereby ratified, confirmed and approved.

There being no further business to come before the meeting, on motion duly made, seconded and carried, it was adjourned at 4:00 p.m.

/s/ LAWRENCE W. SCHWEIK
Secretary

DEPOSITION EXHIBIT 242

Questionnaire from Bell, Boyd, Lloyd, Haddad & Burns to National Industries, Inc., February 3, 1969.

To National Industries, Inc.

In connection with the preparation of the proxy statement of TSC Industries, Inc. ("TSC") for the 1969 annual stockholders' meeting and in connection with the registration of shares of TSC with the Securities and Exchange Commission on form S-1, it is necessary to obtain or verify the information covered by the following questions. Your signature at the end of this questionnaire will constitute your consent to the use of the information contained in your answers in the proxy statement and the registration statement.

Please fill in answers to all items, except where instructed otherwise, and *return two completed and signed copies to me.* The third copy is for your files.

Since the information called for by these questions is needed immediately for the preparation of the documents referred to above, please return your completed questionnaire in duplicate *by February 7, 1969.*

Very truly yours,

Cameron S. Avery
Bell, Boyd, Lloyd, Haddad & Burns
135 South LaSalle Street
Chicago, Illinois 60603
312/AN3-1131

1. Please state below the number of shares of TSC and National Industries, Inc. owned by you or members of your family on 2/7, 1969. (If none, please so state in each case.)

	No. of shares owned 1-31-69			
	TSC		National Industries	
Nature of ownership	Cum. Conv. (Pref.)	Common	Pref.	Common
a. Shares owned by you both of record and beneficially (1)				
b. Shares owned by you of record only (not beneficially) (2)				
c. Shares owned by you beneficially only (not of record) (3)				
d. Shares owned beneficially by your wife, your minor children and other relatives of you or your wife who live in your home (4)				

(1) Both registered in your name in the records of TSC and held for your own benefit.

(2) Registered in your name in the records of TSC but held by you for the benefit of someone else (e.g. held by you as executor, trustee or nominee for other persons).

(3) Registered in the records of TSC in the name of someone else but held by the registered owner for your benefit (e.g. held by a broker, custodian, trustee, pledgee, partnership or corporation over whose management and policies you have control, alone or with others).

(4) Shares owned by you and your wife as joint tenants should be listed only in part (a) or (c) and not in part (d). If

any shares reported in part (d) are also reported in part (b), please so indicate.

2. Did you and all of your "associates" together own beneficially more than 99,000 preferred shares or more than 163,000 common shares of TSC on January 31, 1969.

   Answer /s/ See Item 1.

   If so, please state on the reverse side of this page the name of each such "associate" and the number of common shares of the company beneficially owned by such "associate" on that date. By "associate" is meant (a) any corporation or organization (other than TSC or any of its subsidiaries) of which you are an officer or partner or are directly or indirectly the beneficial owner of 10% or more of any class of equity securities, (b) any trust or other estate in which you have a substantial beneficial interest or as to which you serve as trustee or in a similar fiduciary capacity, and (c) your wife or any relative of you or your wife who lives in your home or who is a director or officer of TSC or any of its subsidiaries.

3. Do you know of any person who owned of record or beneficially more than 99,000 preferred shares or more than 163,000 common shares of TSC on January 31, 1969 other than Charles E. Schmidt?

   Answer /s/ See Item 1.

   If so, please name such person on the reverse side of this page and state the approximate amount of such outstanding shares owned of record but not owned beneficially and the approximate amount owned beneficially by such person on that date.

4. Since October 31, 1967 have you been granted or have you exercised any options for the purchase of shares of

TSC or of any of its predecessors or subsidiaries, or do you now hold any such options?

Answer /s/ No.

If so please state on the reverse side of this page the date or dates of such grant or exercise, the number and class of shares of TSC to which the options relate and the exercise price per share.

5. Has your wife or any relative of you or your wife, who lives in your home or who is a director or officer of TSC received aggregate remuneration in excess of $30,000 from TSC or any of its subsidiaries for services during the last fiscal year.

   Answer /s/ No.

   If so, please state on the reverse side of this page the name of each such person, their relationship to you or your wife, the capacity in which such remuneration was received and the amount so received.

6. Have you received any indirect remuneration from TSC or any predecessor corporation or any of their subsidiaries since October 31, 1967?

   Answer /s/ No.

   If the answer is "yes", please give details on the reverse side of this page. Indirect remuneration might include compensation paid by TSC or any of its subsidiaries to a partnership in which you are a partner or to a corporation in which you and your "associates" (as defined in question 2) own in the aggregate 10% or more of any class of equity securities.

7. Have you or any of your "associates" (as defined in question 2) been indebted to TSC or any of its predecessors or subsidiaries in an aggregate amount in excess of $10,000 at any time since October 31, 1967?

Answer /s/ No.

In determining the amount of indebtedness exclude all amounts due for purchases subject to usual trade terms, for ordinary travel and expense advances and for other transactions in the ordinary course of business. If the answer is "yes", please state on the reverse side of this page the largest aggregate amount of such indebtedness outstanding at any time during such period, the nature of the indebtedness and of the transaction in which it was incurred, the amount thereof outstanding as of November 30, 1968 and the rate of interest paid or charged thereon.

Your attention is directed to the fact that if you have purchased and sold or sold and purchased any shares of TSC or of any predecessor corporation under such condition that you may be liable to pay any profits on such transactions to TSC, such liability is an "indebtedness" within the meaning of that term as used above.

8. Have you or any of your "associates" (as defined in question 2) had any material interest, direct or indirect, in any transactions since November 30, 1965 to which TSC or any of its predecessors or subsidiaries was a party, or in any proposed transaction to which TSC or any of its subsidiaries is to be a party?

Answer /s/ No.

If so, please give details on the reverse side of this page. A person who has a position or relationship with a firm, corporation, or other entity which engages in a transaction with TSC or any of its subsidiaries may have an indirect interest in such transaction by reason of such position or relationship. This question does not apply to any interest arising solely from the ownership of shares of TSC where such stock-

holders received no extra or special benefit not shared on a pro rata basis by all other stockholders of the same class of shares, nor does it apply to direct remuneration paid to directors and officers for services to TSC or any of its subsidiaries, nor where the interest in the transaction is solely that of a director of another corporation which is a party to the transaction.

9. Have you, your wife, your children under the age of 21 or other relatives of yours (including children over age 20) who share your home had a material interest, direct or indirect, in any transactions since October 31, 1967, or will you or any other such person have such an interest in any presently proposed transaction, to which any pension, retirement, savings or similar plan provided by TSC or any of its predecessors or subsidiaries was or is to be a party?

Answer /s/ No.

If the answer is "yes", please identify on the reverse side of this page the holder of such an interest and his relationship to such other party, and state the nature of his interest in the transaction and the amount of such interest. Your answer should include any remuneration received or any loans received or outstanding during the period, or proposed to be received. No information need be given as to payments to the plan or payments to beneficiaries pursuant to the terms of the plan.

10. Are you a director, officer, partner, employee or agent of, or the owner of record or beneficially of the securities of any class of, or otherwise associated with any enterprise engaged in the business of buying and selling securities?

Answer /s/ No.

If so, please give details on the reverse side of this page.

11. Are you or any of your associates a party adverse to the company or any of its subsidiaries in any legal preceding?

Answer /s/ No.

If so, please give details on the reverse side of this page.

12. (Only directors or nominees for the board of directors need reply to this question.) Has your principal occupation for the past five years been employment with TSC or any of its predecessors or subsidiaries?

Answer /s/ No.

If not, please list each principal occupation during that period, including name of organization, positions held and period of time, on the reverse side of this page.

13. (Only directors or nominees for the board of directors need reply to this question.) Do you expect to be elected as a director pursuant to any arrangement or understanding between yourself and any other person or persons, except directors and officers of TSC acting solely in that capacity?

Answer /s/ No.

If so, please name such other person or persons on the reverse side of this page and describe briefly such arrangement or understanding.

14. To your knowledge are more than 10% of the outstanding shares of TSC held or to be held subject to any voting trust or other similar arrangement?

Answer /s/ No.

If so, please state on the reverse side of this page the number of shares involved, the duration of the arrangement, and the names and addresses of the voting trustees and their powers and rights, to the extent of your information.

15. Do you know of any arrangements (other than those which may be provided for in an underwriting agreement or in an agreement among underwriters or in a selected dealers agreement of underwriters, if any, in connection with the proposed registered offering of common shares of TSC), made or to be made by any person for the purpose of (a) limiting or restricting the sale of the shares of the company for the period of the distribution of the shares in the proposed registered offering or (b) stabilizing the market for the shares of TSC?

Answer /s/ No.

If so, please give details on the reverse side of this page.

16. Do you know of any contract or agreement, other than the certificate of incorporation of TSC, under which any director or officer of the company is insured or indemnified in any manner against any liability which he may incur in his capacity as such?

Answer /s/ No.

If so, please give details on the reverse side of this page.

17. To your knowledge, has there been a change in the control of TSC since October 31, 1967?

Answer /s/ Yes. See enclosed papers.

If so, please state on the reverse side of this page the name of the person or persons who acquired such control, the basis of such control, the date and a description of the transaction or transactions in which control was acquired and the percentage of voting

securities of the issuer now owned by such person or persons, in each case to the best of your knowledge.

18. Do you know of any contractual arrangements, including any pledge of securities of TSC, the operation of the terms of which could at a future date result in a change in control of TSC?

Answer /s/ No.

If so, please give details on the reverse side of this page.

* * * * *

I consent to and approve the use in the manner contemplated of the information supplied herein by me, and I will inform TSC Industries, Inc. of any material changes which may occur between the date hereof and the effective date of the registration statement.

Dated _____, 1969.

_____

(Signature)

_____

DEPOSITION EXHIBIT 255.

TSC Industries, Inc. Form 10-K, Filed with Securities Exchange Commission, February 27, 1969.

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended October 31, 1968 Commission file number 1-5554-1

TSC INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	36-2646252
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4747 North Ravenswood Avenue, Chicago, Illinois (Address of principal executive office)	60640 (Zip Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $1.00 Par Value	New York Stock Exchange
$.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1	New York Stock Exchange

Item 1. Number of Equity Security Holders (As of December 1, 1968)

(A) Title of Class	(B) Number of Record Holders
Common Stock, $1.00 Par Value	4,172
$.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1	2,433

Item 2. Increases and Decreases in Outstanding Equity Securities

On February 19, 1968, Tractor Supply Co. (Tractor) and Community Discount Centers, Inc. (Community), Illinois corporations, were merged into the registrant, a wholly-owned subsidiary of Tractor with 100 shares of common stock outstanding (which were cancelled in the merger), and the shares of said Illinois corporations were converted into shares of the registrant on February 19, 1968 in accordance with the merger agreement. The merger was described in the registrant's registration statement on Form S-B filed January 8, 1968.

The shares of Tractor and Community outstanding on February 19, 1968 and the shares issued by the registrant upon conversion thereof pursuant to the merger were reported in the registrant's current report on Form 8-K for February, 1968, as follows:

Tractor	Class A shares outstanding 2/19/68	1,336,923
	Less number held by stockholders who dissented from the merger	38
	Balance	1,336,885
Community	Common shares outstanding 2/19/68	1,311,718
	Less number held by stockholders who dissented from the merger	255
	Balance	1,311,463

Registrant: On February 19, 1968, 1,336,885 Class A shares of Tractor were converted into 1,336,885 shares

of common stock, $1.00 par value, of the registrant, and 1,311,463 common shares of Community were converted into 1,311,463 shares of $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1, of the registrant.

Increases and decreases in the outstanding shares of the registrant from February 19, 1968 through October 31, 1968 are reported below:

Title of Class	Date of Transaction	Increase (Decrease) in Shares	
Common Stock, $1.00 par value	Various: Feb. - Oct. 1968	67,054	(1)
	August 1968	4,000	(1)
	Total increase	71,054	
$.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1	April 1968	73,000	(2)
	Various: Feb. - Oct. 1968	(89,412)	(1)
	July 1968	1,500	(3)
	October 1968	400	(3)
		50	(4)
	Total decrease	(14,462)	

(1) Reported in Form 8-K report for October 1968

(2) Reported in Form 8-K report for April 1968

(3) Shares issued pursuant to exercise of employee stock options. Exempt from registration by Section 4(2) of the Securities Act of 1933 as transaction by an issuer not involving any public offering.

(4) Adjustment to reflect fact that of the 255 common shares of Community held by stockholders who dissented from the merger, only 205 shares were cancelled by the payment of cash; the remaining 50 shares were converted into 50 shares of cumulative convertible stock.

RECAPITULATION

Common Stock, $1.00 par value	Outstanding February 19, 1968 after merger	1,336,885
	Increase shown above	71,054
	Total October 31, 1968	1,407,939
$.70 Cumulative Convertible Stock (preferred as to dividends), Series 1	Outstanding February 19, 1968 after merger	1,311,463
	Decrease shown above	(14,462)
	Total October 31, 1968	1,297,001

Item 3. Parents and Subsidiaries of Registrant

(a) Parents of registrant

On February 7, 1969, National Industries, Inc., a Kentucky corporation, with principal offices at 510 West Broadway, Louisville, Kentucky, purchased from Charles E. Schmidt, his wife, his two sons, and a foundation of which he is a trustee, 434,682 shares of common stock of registrant and 439,675 shares of $.70 Cumulative Convertible Stock (Preferred as to Dividends), Series 1, of the registrant, or 26.5% and 44.5%, respectively, of the total number of shares of such common stock and of such cumulative convertible stock of the registrant outstanding on that date. The shares so purchased constituted approximately one-third of the voting securities of the registrant outstanding on that date.

National Industries, Inc. may be deemed to be a "parent" of the registrant within the meaning of the rules and regulations of the Securities and Exchange Commission adopted under the Securities Act of 1933.

(b) Subsidiaries of the registrant (all 100% owned)

Corporate Name	State of Incorporation
Big Bear, Inc. which owns 100% of stock in:	Minnesota
(a) Big Bear of Algona, Inc.	Iowa
(b) Big Bear of Anoka, Inc.	Minnesota
(c) Big Bear of Austin, Inc.	Minnesota
(d) Big Bear of Boone, Inc.	Iowa
(e) Big Bear of Burlington, Inc.	Iowa
(f) Big Bear of Chariton, Inc.	Iowa
(g) Big Bear of Decorah, Inc.	Minnesota
(h) Big Bear of Grinnell, Inc.	Minnesota
(i) Big Bear of Hutchinson, Inc.	Minnesota
(j) Big Bear of Knoxville, Inc.	Nebraska
(k) Big Bear of Newton, Inc.	Minnesota
(l) Big Bear of Oelwein, Inc.	Iowa
(m) Big Bear of Oskaloosa, Inc.	Minnesota
(n) Big Bear of Ottumwa, Inc.	Minnesota
(o) Big Bear of Prairie du Chien, Inc.	Wisconsin
(p) Big Bear of St. Cloud, Inc.	North Dakota
(q) P and K Incorporated	Minnesota
Branch Realty Corporation	Illinois
Community Discount Centers, Inc. which owns 100% of stock in:	Delaware
(a) Goodman Community Discount Centers, Inc.**	Illinois
(b) Lincolnwood Plaza, Inc.**	Illinois
(c) Mages Sporting Goods Co.**	Illinois
(d) M & H Sporting Goods Company	Pennsylvania
(e) Shoppers World Co.**	Illinois
D. C. Development Corporation	Illinois
Genuine Parts Co.	Illinois
Huskee-Bilt Construction Co.	Illinois
Mages Sports Arenas, Inc.***	Delaware
Richland Industries Inc.	Wisconsin
Robertson's Farm Supply, Inc. which owns 100% of stock in:	Illinois
Western Mercantile Company	Missouri
SAS, Inc.* which owns 100% of stock in:	South Dakota
(a) Standard Auto Supply of Aberdeen, Incorporated	South Dakota
(b) Standard Auto Supply of Redfield, Incorporated	South Dakota
(c) Prairie Distributors, Incorporated	South Dakota
(d) Jamestown Motor Supply, Inc.	North Dakota
Spindle Specialty Co.	California
Sporting Goods Credit Corporation	Pennsylvania
Thrive Centers, Inc.	Illinois
Tractor Supply Co.**	Delaware
Tractor Supply Co., Inc.	New York

Corporate Name	*State of Incorporation*
Tractor Supply Company	California
Tractor Supply Company	Minnesota
Tractor Supply Company	Tennessee
Tractor Supply Company	Texas
which owns 100% of stock in:	
Tractor Supply Co.**	Florida
TSC Franchises, Inc.	Illinois
T. S. C. Realty, Inc.	Indiana
T S C Stores Ltd.	Canada

*Non-operating holding companies.
**Inactive.
***The financial statements of all of the subsidiaries except Mages Sports Arenas, Inc. are included in the consolidated financial statements.

Item 4 to 9 Inclusive

The registrant, after the close of its fiscal year, filed with the Securities and Exchange Commission a definitive proxy statement pursuant to regulation 14A which involved the election of directors at an annual meeting called to be held February 10, 1969. Said annual meeting was adjourned to March 31, 1969 to permit the registrant to submit to stockholders a revised proxy statement disclosing the purchase of stock by National Industries, Inc., referred to in paragraph (a) of Item 3 hereof, and the new slate of nominees for directors giving recognition to such stock purchase by National. The revised proxy statement will be mailed to stockholders early in March, 1969.

Item 10. Financial Statements and Exhibits

(a) Financial Statements

The consolidated financial statements and related schedules of the registrant and its consolidated subsidiaries for the fiscal year ended October 31, 1968, included in the registration statement on Form S-1, No. 2-31393 now pending, are incorporated in this report by this reference thereto.

(b) Exhibits

1. Stock option plan of registrant (exhibit 5.1 to registration statement No. 2-31393)*

2. Form of stock option certificate issued pursuant to registrant's stock option plan (exhibit 5.2 to said statement No. 2-31393)*

3. Amendment dated May 13, 1968, to employment agreement of Gardner Abbott (exhibit 13.3(b) to said statement No. 2-31393)*

4. Employment agreement dated November 7, 1967 between Community Discount Centers, Inc. and Carl W. Sharfman and amendment dated December 31, 1967 (exhibit 13.5 to said statement No. 2-31393)*

* Incorporated by reference.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this annual report to be signed on its behalf by the undersigned thereunto duly authorized.

TSC INDUSTRIES, INC.
(Registrant)

By Gardner Abbott
Gardner Abbott, Chairman
of the Board of Directors

Date February 27, 1969

CONSENT

We consent to the incorporation by reference of the consolidated financial statements of the registrant for the year ended October 31, 1968 as provided in Item 10 (a) of this report.

Checkers, Simon & Rosner
CHECKERS, SIMON & ROSNER

Date February 27, 1969

DEPOSITION EXHIBIT 256.

TSC Industries, Inc. Form 8-K, Filed with Securities Exchange Commission, March 7, 1969.

Securities and Exchange Commission
Washington, D. C. 20549

Form 8-K

Current Report

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Month of February, 1969

TSC Industries, Inc.
(Exact name of registrant as specified in charter)

4747 North Ravenswood Avenue
Chicago, Illinois 60640

(Address of principal executive offices)

Item 1. Changes in Control of Registrant.

Reference is made to Item 3(a) of registrant's annual report filed on Form 10-K for the fiscal year ending October 31, 1968.

Item 11. Submission of Matters to Vote of Security Holders.

Reference is made to Item 4 to 9 inclusive of registrant's annual report filed on Form 10-K for the fiscal year ending October 31, 1968.

Item 13. Financial Statements and Exhibits.

(a) Financial Statements

(b) Exhibits

4 (b)-5. Amendment dated February 5, 1969 to the registrant's stock bonus trust agreement (being the stock bonus

trust agreement which was adopted by the registrant in connection with the merger of Tractor Supply Co. into the registrant on February 19, 1968).

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

TSC INDUSTRIES, INC.
By /s/ GARDNER ABBOTT
Gardner Abbott
Chairman of the Board of Directors

March 7, 1969.

DEPOSITION EXHIBIT 357.

Letter from Blancke Noyes to Stanley R. Yarmuth, President, National Industries, Inc., October 31, 1969.

Mr. Stanley Yarmuth, President
National Industries Inc.
510 West Broadway
Louisville, Kentucky 40201

Dear Stanley:

You have asked for our opinion as to the value of warrants to be issued in connection with your proposed acquisition of TSC Industries. We understand that these warrants have terms identical to the National Industries (NII) warrants listed on the American Stock Exchange which allow the holder to purchase one NII Common at the price of $21.40 until October 31, 1978. We further understand that you desire our determination as of October 9, 1969.

Our evaluation of these warrants was made from the point of view of the stockholders of TSC Industries, of which I am a director. In advising TSC as to the fairness of the offer from NII it was necessary to determine whether the value of the warrants was reflected by the market price of the outstanding 487,000 warrants on the day in question. We did so in the light of the fact that approximately 2.6 million additional warrants would be issued in connection with the acquisition.

After studying price relationships of other warrants traded publicly, referring to customary systems of warrant evaluation, and considering the particulars of the proposed acquisition, we concluded that the warrants in question had a value of approximately $3.50.

If you have any questions concerning our evaluation, please feel free to call.

Sincerely,

/s/ BLANCKE NOYES,
Blancke Noyes,
General Partner.

DEPOSITION EXHIBIT 409.

Letter from Allan B. Solomon, Vice President, National Industries, Inc. to Edward A. Merkle,

August 1, 1967.

Mr. Edward A. Merkle
Madison Fund, Inc.
660 Madison Avenue
New York, New York 10021

Dear Mr. Merkle:

In accordance with our understanding, you are being employed by National Industries, Inc. to perform certain duties under the following terms and conditions:

1. You agree to provide at least one day per month as an employee of the Company with such duties as may reasonably be requested by its Board of Directors or officers.
2. We shall pay you and you shall accept for such services compensation at the rate of $2,500.00 per annum, payable semi-annually. It is understood that you will pay all necessary expenses from such compensation.
3. As further inducement to you to enter into this agreement, we hereby agree to grant you an option to purchase 10,000 shares of the Common Stock of the Company at the price of $7.25 per share, being the asked price for our stock on the date hereof, subject to the terms of the qualified Stock Option Plan and Stock Option Agreement attached hereto.

If the above sets forth your understanding, kindly indicate your consent on the enclosed copy of this letter and return it to me whereupon this will be a legally binding agreement between

us. Please also sign and return the copy of the Stock Option Agreement that does not have the Stock Option Plan attached.

Very truly yours,

NATIONAL INDUSTRIES, INC.
/s/ ALLAN B. SOLOMON,
Allan B. Solomon,
Vice President.

Enclosures

Consented to this 1st day of August, 1967.

/s/ EDWARD A. MERKLE,
Edward A. Merkle.

DEPOSITION EXHIBIT 414.

Letter from Stanley R. Yarmuth, President, National Industries, Inc. to Edward A. Merkle, October 1, 1968.

Mr. Edward A. Merkle
Madison Fund, Inc.
600 Madison Avenue
New York, New York 10021

Dear Mr. Merkle:

In accordance with our mutual understanding, our agreement of August 1, 1967 is modified so that, effective this date, you are to be paid $12,000 per annum payable semi-annually for your services as an employee of this corporation.

All of the other terms and conditions of the August 1, 1967 agreement remain in full force and effect.

Very truly yours,

NATIONAL INDUSTRIES, INC.,
By: /s/ STANLEY R. YARMUTH,
President.

pam

Consented to this 1st day of October, 1968.
/s/ EDWARD A. MERKLE,
Edward A. Merkle.

DEFENDANTS' DEPOSITION EXHIBIT 6.

Summary of Current Analysis of TSC Acquisition by Erwin E. Nemmers, November 5, 1971.

I. *Problem.*

Examination of fairness of acquisition terms presented in Proxy dated 11-12-69, including valuation of TSC business and valuation of securities issued by National for such acquisition.

Terms of Exchange per Proxy Statement (Proxy p. 7):

1. Each share TSC pfd. ($0.70 div., convertible into 0.75 share common, redeemable at $17.00) gets:
   0.6 National B pfd. ($1.25 div., convertible into 0.75 share common, redeemable at $26.00)
   and 1 National warrant to buy National common at $21.40 until October 31, 1978.
2. Each share TSC common gets:
   0.5 National B pfd. as above.
   and 1.5 National warrant as above.

II. *Summary of Conclusions.*

1. Standard exchange terms analysis at outset indicates that on a common for common basis, TSC common stockholders should get more than two National common for each share of TSC common. Here TSC common stockholders get no National common and are converted into National B pfd. stockholders at the rate of ½ B pfd. and 1½ warrants worth a total of only $7.88. This is to be compared with a fair value of $29.80 — $36.40 per share of TSC common.

2. Analysis of spillover shows that TSC stockholders other than National give up over $1 Million in annual earnings with little or no increase in dividends. In addition, they must give all dividends in order to get a common earnings position, and thereby would sacrifice $1,218,750 in B pfd. dividends

for $646,828 in annual earnings. These TSC stockholders brought about 32% of the combined earnings to the deal, but get only 18% (if hold B pfd.) and only 9% of these earnings if convert all B pfd.

3. Comparison of value given up by TSC stockholders other than National shows that they gave up between $51.2 and $61.8 Million and received only $14.7 Million with a resulting loss of between $36.4 and $47 Million.

4. Expressed on a per share basis in terms of the exchange ratio in this deal:

(a) Each share of TSC common:			
gives up:		$29.80	$36.40
gets:			
0.5 Nat'l. B Pfd.*	5.63		
1.5 Warrants**	2.25	$ 7.88	$ 7.88
Difference—Loss		$21.92	$28.52
(b) Each share of TSC Preferred:			
gives up:		$22.55	$27.30
gets:			
0.6 Nat'l. B Pfd.*	6.75		
1 Warrant**	1.50	$ 8.25	$ 8.25
Difference Loss		$14.30	$19.05

* National B pfd. valued at $11.25 per share.

** National Warrant valued at $1.50 per warrant.

III. *Standard Exchange Terms Analysis—(Using National Common Stock for TSC Common Stock).*

	Common Share		Indicated Exchange Ratio	
	Nat.	TSC	Nat.	TSC
	(in part Proxy, p. 23)			
Dividends	2% stk.	$ 0.56	—	—
Earnings—most recent 12 mos.				
Unadjusted (Claimed Pre-extraordinary)	$ 0.83	$ 1.16*	1.40 to 1.00	
Adjusted for Elimination of TSC extraordinary	$ 0.83	$ 1.58**	1.90 to 1.00	
Earnings (Diluted)—most recent 12 mos.				
Unadjusted (Claimed Pre-extraordinary)	$ 0.81	$ 1.08***	1.33 to 1.00	
Adjusted for elimination of TSC extraordinary	$ 0.81	$ 1.46****	1.80 to 1.00	
Book Value	$ 9.11	$ 9.93	1.09 to 1.00	
Market Price:				
October 1, 1969	$10.00	$13.75	1.37 to 1.00	
November 7, 1969	$10.25	$13.25	1.29 to 1.00	

* Using $1,888,000 (Proxy, p. 21) and $1.16 indicates average number of shares equals approximately 1,620,000.

** $1,888,000 (Proxy, p. 21) + adjustment of $672,332 (IV (2) below)) after tax = $2,560,332 dividend by 1,620,000 shares = $1.58.

*** Using $1,888,000 (Proxy, p. 21) and $1.08 indicates average number of shares equals approximately 1,750,000 shares.

**** $2,560,332 (** above) divided by 1,750,000 shares.

Adjusted values (TSC adjusted):	Common Share Nat.	Common Share TSC	Indicated Exchange Ratio Nat.	Indicated Exchange Ratio TSC
October 1, 1969	$10.00	$31.60(a)	3.16 to 1.00	
November 7, 1969	$10.25	$31.60	3.08 to 1.00	
October 1, 1969	$10.00	$29.80(b)	2.98 to 1.00	
November 7, 1969	$10.25	$29.80	2.91 to 1.00	
October 1, 1969	$10.00	$34.80(c)	3.48 to 1.00	
November 7, 1969	$10.25	$34.80	3.40 to 1.00	

On basis of three-year averages of common earnings (ordinary) of TSC and National:

	1966	1967	1968	Average
National (year end 12/31)	$0.52	$0.77	$0.97	$0.75
TSC (year end 10/31)	1.24	1.57	2.10	1.64

Indicated exchange ratio: 2 Natl for 1 TSC

	1967	1968	Annualized 1969	Average
National (year end 12/31)	$0.77	$0.97	$0.54(d)	$ .76
TSC (year end 10/31)	1.57	2.10	0.97(e)	1.53

Indicated exchange ratio: 2 Nat'l for 1 TSC

		Adjusted Annualized		
National	0.77	0.97	0.54	0.76
TSC	1.57	2.10	1.49	1.72

Indicated exchange ratio: 2.3 Nat'l for 1 TSC

(a) $1.58 earning per share above at a P/E of 20.

(b) TSC valued on basis of July 31, 1969 earnings (9 mo.) adjusted for extraordinary and annualized $1.49 at a P/E of 20 (V (3) below).

(c) TSC valued on basis of earnings annualized after adjusting 6 months ended July 31, 1969 for deteriorated management, $1.74 at a P/E of 20 (V (3) below).

(Continued on p. 527)

			Adjusted Management	
National	0.77	0.97	0.54(f)	0.76
TSC	1.57	2.10	1.74	1.80

Indicated exchange ratio: 2.4 Nat'l for 1 TSC

Conclusion:

Each TSC common should get more than 2 Nat. common with TSC pfd. on comparable basis since TSC pfd. sells and is valued on an arbitrage basis.

Note: In this exchange each share of TSC common gets 0.5 National B pfd. and 1.5 National warrants worth a total of $7.88.

Note: Data on page 23 of Proxy Statement is misleading, even to an informed TSC investor.

1. Earnings (income) after deal are stated as if TSC stockholders get *both* earnings position ($0.36 and $0.43) *and* dividends (of $0.63 and $0.75).
2. The same misimpression is emphasized by showing post deal fully diluted earnings (income) as if TSC stockholders get *both* earnings position ($0.35 and $0.41) and above dividends.
3. In fact, TSC stockholders must convert their National B pfd. into National common stock to get an earnings position, but must thereby give up their B pfd. dividend. Cannot have both as shown.
4. Moreover, the after deal income figures shown on page 23 are inconsistent and invalid.
   (a) Income per share of National Common ($0.95) appears to be computed on basis that the National A pfd. and B pfd., including the B pfd. to be issued in this deal, remains outstanding and is not converted into National common. No adjustment is made for the 2,511,000 warrants to be issued in the deal (Proxy pages 17, 21 and 22) to get common equivalents.

(Continued from page 526)

(d) Proxy, p. 15.

(e) As reported.

(f) 1st quarter actual for TSC + 3 quarters adjusted management.

(b) But at the same line, using the same row and column headings, after deal earnings (income) figures are stated for TSC pfd. and common stockholders. Assuming no conversion, the table should show *no* earnings position for TSC pfd. and common after the deal.

(c) In addition, the after deal earnings (income) stated for TSC stockholders is not accurate if the requirement of converting their National B pfd. is taken into account. The after deal earnings stated in the table are merely a multiplication of:

$$\$0.95 \times .75^{*} \times .6^{**} = \$0.43$$
$$\$0.95 \times .75^{*} \times .5^{***} = \$0.36$$

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* Each share of National B pfd. converts to .75 shares of common.

** Each TSC pfd. gets .6 share of National B pfd.

*** Each TSC common gets .5 share of National B pfd.

Computation of 95¢: 7,223,000 shares (p. 17) — 194,000 shares (Nat. A) = 7,029,000 shares.

$8,165,000 — 1,446,000 = $6,719,000 — $82,800 (Nat. A div.) =6,636,200

IV. *The Gross Unfairness of the Transaction Is Demonstrated by Spill-Over Analysis Which Is Essentially a Forward-Looking Technique.*

1. *Using TSC—9 mo. 1969 Earnings Annualized*

	Pre Deal	Post Deal Unconverted	Post Deal Converted
Pfd. Div.	$ 638,829(a)		
Common earnings as stated	1,739,784(b)		
Adjustment for extraordinary	896,442(c)		
Total TSC Earnings	$3,275,055		
Ex National			
Pfd. Div.	331,057(d)	$1,218,750(h)	$None
Common earnings as stated	1,252,644(e)	None	$646,828(i)(j)
Adjustment for extraordinary	645,448(f)		
Total Earnings accruing to Non-Nat. TSC Holders	$2,229,149	$1,218,750	$646,828
Dividends Received by Non-National TSC Holders			
Pfd. Div.	331,057(d)	1,218,750 (Com. & Pfd.)	None
Common Div.	799,227(g)	None	None
Total Dividends received by Non-National TSC Holders	$1,130,284	$1,218,750	

(a) Annual preferred dividend requirement, p. 73: 912,613 shares × $0.70

(b) $1,784,466 (p. 19) × 1.333 = $2,378,613
$2,378,613 — $638,829 = $1,739,784

(Continued on page 530)

(Continued from page 529)

(c) After-tax (50%) of adjustment of $1,344,664 (Part V) is $672,332 × 1.333 (annualized) = $896,442

(d) Nat's 439,675 shares (p. 13) × $.7 = $307,772; $638,829 — $307,772 = $331,057

(e) Nat. owns 519,733 (p. 13) of common or 28% of 1,851,778 common (p. 73) $1,739,784 × 0.72 = $1,252,644 owned by non-Nat. TSC common

(f) $896,442 at 72% = $645,438

(g) 1,851,778 shares — 519,733 held by Nat. = 1,332,045 × $.60

(h) 975,000 shares (proxy p. 13) at $1.25 = $1,218,750

(i)

National's annualized earnings 2 × $2,071,000 (Proxy p. 14)	$4,142,000	
less TSC dividends received*	573,141	
		3,568,859
TSC Annualized earnings as stated (note b above)	2,378,613	
Adjustment for extraordinary (Note c)	896,442	
Total TSC Earnings		3,275,055
Total earnings NII after Acquisition		$6,843,914
Less Pfd. req., Non TSC		
Nat. A 138,000 at $.60	82,800	
Nat. B 182,000 at $1.25	227,500	
		310,300
		$6,533,614
Available to Common 9.9%		646,828

After conversion, TSC people would own 975,000 Nat. B (Proxy p. 13) which is equivalent to 731,250 common (¾ of 975,000 = 731,250) out of a total of 7,346,250 (6,615,000 + 731,250); (6,615,000 from Proxy p. 13)
731,250/7,346,250 = 9.9%

Computation of Dividend

Nat. owns 519,733 shares TSC common at $0.60	=	$311,839
Nat. owns 439,675 shares TSC pfd. at $0.70	=	307,772
		$619,611
Tax 7.5% (50% of 15%; 85% excluded)		46,470
		$573,141

(j) Warrants do not enter consideration since exercise of the warrants would require more than $53 Million cash ante by TSC holders.

2. *If we repeat the spill-over analysis using most recent twelve months earnings (p. 21):*

	Pre Deal	Unconverted Post Deal	Post if Converted
Pfd. Div.	$ 774,000		
Common earnings as stated	1,888,000		
Adjustment for extraordinary	672,332(a)		
Total TSC Earnings	$3,334,332		
Ex National			
Pfd. Div.	466,228(b)	$1,218,750	None
Common earnings as stated	1,359,360(c)	None	809,832(g)
Adjustment for extraordinary	484,079(d)	—	
Total Earnings accruing to Non-National TSC Holders	$2,309,647	$1,218,750	$809,832
Dividends received by Non-National TSC Holders			
Pfd. Div.	466,228(b)	1,218,750 (Com. & Pfd.)	None
Common Div.	745,923(e)	None	None
Total Dividends received by Non-National TSC Holders	$1,212,151	$1,218,750	

(a) After tax half of $1,344,664 add-back (Part V) = $672,332
(b) $774,000 — $307,772 (which is 439,675 × $.7)
(c) 1,888,000 (.72) = $1,359,360
(d) $672,332 (.72)
(e) 1,851,778 sh — 519,773 held by Nat. × .56

(Continued on page 532)

Conclusion.

Looking at the effect of this deal on the TSC stockholders, other than National, shows unfair loss of position which they suffer.

1. In return for a slight increase in total dividend (virtually no increase on basis of last 12 months), TSC stockholders lose over $1 Million per year in total earnings of TSC.

2. In order to get any position in the after deal common earnings, TSC stockholders must give up all their B pfd. dividends of $1,218,750 and would thereby get only $646,828 (or $809,832 on last 12 month basis) per year. This would be 30% of their own pre-deal earnings (35% on last 12 month basis).

3. In addition, TSC stockholders other than National, contributed 32.5% ($2,229,149/$6,843,914) to the total combined after deal earnings, but get only 18% ($1,218,750/$6,843,914) of total if hold their B pfd. and 9% ($646,828/$6,843,914) if they convert the B pfd. into National common. Result is essentially the same on a last 12 month basis.

(Continued from p. 531)

(f) Income before extraordinary (p. 21)		$8,165,000
Add adjustments to extraordinary		672,332
		8,837,332
Less dividends due National*		346,910
		8,490,422
Less pfd. div. req. non-TSC		310,300
		8,180,122
Available to Common — 9.9%		809,832

* On 435,675 pfd. (.70)	307,772	
On 519,733 Com. (.56)	291,050	
	598,822	
Less 7.5% tax	44,912	
	553,910	
Less $207,000 (net of tax incl. in 8,165,000	207,000	
	346,910	

(g) Warrants do not enter consideration since exercise of the warrants would require more than $53 Million cash ante by TSC holders.

V. *Valuation of TSC Business.*

1. *Adjustment of Earnings as Reported (9 mo. 7/31/69).*

9 months income before taxes and extraordinary items per proxy statement, p. 19	$3,549,466
Add back extraordinary items not disclosed in proxy:	
Extraordinary markdowns or write-offs Computed as $254,000 in ex 289 Community (accounting sheet and Ex 250) $366,000 in ex 289 K. C.	620,000
Extraordinary charges for anticipated loss on asset disposition	144,000
Computed as Villa Park 113,000 Madison St. 31,000 Exhibits 250, 289	
Extraordinary charges for contract termination, Ex 250	62,500
Extraordinary losses K. C. stores	518,164
Computed as 9 mos. KC 884,164 Ex 289 above —366,000 518,164 Also Ex 297 $884,164 is $938,000 — $54,000, p. 2, Ex 289	
Ability to dispose of KC Paid $2,400,000 p. 13 March 18, 1969 Prospectus, Ex 48	
Total adjustment	$1,344,664
Adjusted pre-tax ordinary income for nine months	4,894,130
Less taxes at 50%	2,447,065
Adjusted normal income for nine months	$2,447,065
Annualized (times 1.333) after tax income	$3,261,871

2. *Adjustment for Deteriorated Management—1969.*

There is another adjustment to be considered, namely, over and above the extraordinary items, the operating statistics (p. 19 Proxy) show a deterioration in TSC management from the time of the Schmidt transaction (end of January, 1969).

	TSC As Reported*		
	9 Mos. Ended 7/31/69	3 Mos. Ended 1/31/69	6 Mos. Ended 7/31/69
Sales	$135,965,341	$46,517,762	$89,447,579
Cost of Goods	102,234,521	34,625,172	67,609,349
G&A	29,254,812	9,729,639	19,525,173
Operating Income	3,549,466	1,152,559	2,396,907
Other costs excluding extraordinary	948,542	94,785	853,757
Income—6 mo. 7/31/69 Pre-tax, pre-extraordinary			$ 1,543,150

Per Proxy Statement p. 19 and quarterly statement 1/31/69.

Prior Management Efficiency.

	Year Ended Oct. 31			3 Mos. Ended
	1966	1967	1968	Jan. 31, 1969
% Cost of goods to sales	74.0	73.6	74.0	74.4
% G&A to sales	19.6	20.1	20.9	20.9
% Other costs (net) excluding extraordinary	0.7	0.6	0.6	0.2

NII Management Efficiency.

	6 Mos. Ended 7/31/69	NII Less Schmidt*
% Cost of goods to sales	75.6	1.2
% G&A to sales	21.8	0.9
% other costs (net) excluding extraordinary	1.0	0.3
		2.4

* NII given advantage of *poorest* Schmidt performance in any of four periods (last three years plus stub quarter) using each category of cost separately.

Adjustment to 6 Months Ended 7/31/69.

Pre-Tax, pre extraordinary income under NII Management	$1,543,150
Add back 2.4% of sales $89,447,579	2,146,742
	3,689,892
50% tax	1,844,946
6 mos. profit	1,844,946
Annualized (× 2)	$3,689,892

Note: Adjustment for extraordinary correctly states actual performance of TSC. Adjustment for deteriorated management under NII is an independent determination of what the TSC business should produce at a minimum.

3. *Summary: 1969 TSC Earnings Annualized.*

	As Reported 9 Mos. (Proxy p. 19)	Adjusted for Extraordinary 9 Mos. (V(1) Above))	Adjusted for Deteriorated Management
Normal profit	$1,784,466	$2,447,065	$3,689,892
Less pfd. div. requirement	533,747	533,747	710,972**
Available to common	1,250,719	1,913,318	2,978,920

Per Common Share

	As Reported		Adjusted for Extraordinary		Adjusted for Deteriorated Management
	9 mos.	Annualized	9 mos.	Annualized	Annualized****
Average no. of Common (and equivalents) 1,711,466*	$0.73***	0.97	$1.12	$ 1.49	$ 1.74
Fully diluted 2,510,097*	$0.71***	0.95	$0.98	$ 1.31	$ 1.47
Fair Values—TSC Common:				$29.80	$34.80

* Ex. 317.

** 4/3 of $533,747.

*** Same as proxy p. 20.

**** The earnings would be the same for a year annualized from Nov. 1, 1968 or from February 1, 1969, since TSC earned 43¢ in quarter beginning Nov. 1, 1968 under old TSC management.

4. *The P/E Ratio.*

Study of comparable companies indicates a P/E of 20. TSC was at a P/E of about 20 in 1968. The general market (S&P 425) dropped about 9.7% in 1969, but other companies in TSC group held steady. In 1969 discount stores held favor in the market. TSC had adequate pfd. and interest coverage. TSC common would have carried a P/E of 20 if the earnings in 1969 had been correctly disclosed. Compared with average quarterly P/E for S&P Industrials in 1968 and 1969, growth rate of TSC earnings justifies at least 20 P/E.*

5. *Value of TSC Preferred.*

Fair Values—TSC Preferred:	$22.35	$26.10

The TSC convertible preferred is convertible into ¾ share common. Hence, whether the fair value of TSC common is $29.80 (20 × $1.49) or $34.80 (20 × $1.74), TSC pfd. would sell at arbitrage values; namely, ¾ of $29.80 (which is $22.35) or ¾ of $34.80 (which is $26.10), and not on a yield basis—$0.70 dividend (just over 3% yield when TSC pfd. is $22.35 and less when TSC pfd. is higher).

6. *Fair Value of TSC Business—1969 Earnings Annualized.*

	1969 Adjusted for Extraordinary (Common Earnings $1.49 Per Share)
1,852,603 Common at $29.80 per share	$55,207,569
951,513 Preferred at $22.35 per share	21,266,315
Fair Value of TSC	$76,473,884

	1969 Adjusted for NII Management (Common Earnings $1.74 Per Share)
1,852,603 Common at $34.80 per share	$64,470,584
951,513 Preferred at $26.10 per share	24,834,489
Fair Value of TSC	$89,305,073

* S&P Ind. Average Quarterly P/E

	1968	1969
1st Q.	16.93	18.09
2nd Q.	17.39	16.97
3rd Q.	18.07	15.99
4th Q.	17.80	17.38

7. *Alternate Fair Value of TSC Business on Basis of 3-Year Average Earnings Per Share.*

	1966	1967	1968	Average
TSC earnings per share of Common (Proxy p. 20)	$1.24	$1.57	$2.10	$1.64
Fair Value TSC Common:		$32.80 per share		
Fair Value TSC Preferred:		$24.60 per share		
1,852,603 Common at $32.80 per share		$62,765,378		
951,513 Preferred at $24.60 per share		23,407,220		
Fair Value TSC		$84,172,598		

	1967	1968	1969	Average
TSC Earnings per share Common	$1.57	$2.10	$1.49*	$1.72*
			1.74**	1.82**
Fair Value TSC Common:	$34.40* and $36.40**			
Fair Value TSC Preferred:	$25.80** and $27.30**			
1,852,603 Common at $34.40*	$63,729,543			
951,513 Preferred at $25.80*	24,549,035			
Value TSC	$88,278,578			
1,852,603 Common at $36.40**	$67,434,749			
951,513 Preferred at $27.30**	25,976,305			
	$93,411,054			

Conclusion.

TSC business is valued in the range of $76 to $93 million.

* 1969 TSC Common earnings adjusted to extraordinary (V3 above).
** 1969 TSC Common earnings adjusted for NII management (V3 above).

VI. *Valuation of National Securities Received.*

1. *Value of National Warrants: $1.50 Per Warrant.*

(a) Because of the large increase in number of warrants from 486,576 (p. 69 of Proxy) to 2,997,749 (2,511,173 due to this deal), type of new holder, and because of the large number of total rights to be outstanding after the deal—6,183,000 (Proxy p. 13) relative to common of 6,615,000 *the warrant is highly speculative.*

(b) Abnormal trading volume in Oct., Nov. and Dec. of 1969 when the warrants had a *monthly* turn as high as 196,400/486,576 or 40% when a normal of about 10% was traded in April through Sept. indicates an unreliable market price. National's study (Ex. 227 as amended) when corrected for error indicates the fair value of the warrant is $1.50 on a premium basis.

(c) Methods of warrant valuation:

(1) Arbitrage value—*zero.*

Exercise price ($21.40) is above market price of National common ($10).

(2) Premium method (exercise price less market price of common plus price of warrant as a percent of market price of common—$1.50.

On basis of National's group of warrants (Ex. 227, amended for errors).

(3) Warrant price as a percent of market price of common—$2.00-$3.00.

Ex. 227 amended for error indicates average relationship of 30%. (30% × 10.00 $3.00). IBA Study indicates average relationship which yields warrant price of $2.00 on this basis.

(4) Average of above methods—$1.50.

2. *Value of National "B" Preferred: $11.25 Per Share.*

(a) The market price of the Nat'l B pfd. is also unreliable measure of value for the "B" pfd. to be issued. B pfd. outstanding will be increased from 182,000 to 1,157,000 shares (p. 13 of Proxy); pfd. dividend coverage will be reduced substantially from 13 x down to 4.4 x*, and extremely low interest coverage will not be much improved. (1.8 x to 2.2x) Further, the market price of B pfd. is influenced by market of the Nat'l. warrants,

particularly when market price of warrants (before issuance of 2.5 million warrants) is at $5.25, an unreliable price as above.

(b) National B pfd. carries $1.25 dividend and is convertible into ¾ share common. Arbitrage value is zero. Hence, National B pfd. will sell almost entirely on a yield basis.

(c) Comparison with other speculative industrial preferred stocks (Moody's list) indicates that the National B preferred to be issued in their deal should be valued on basis of a yield of about 11% (11.5% indicated if not convertible).

(1) Worst interest coverage before deal (1.8x) of any of the speculative preferreds on Moody list, and only 2.2x after deal.

(2) Worst preferred dividend coverage (4.4x) after deal than any of the other speculative preferreds on Moody list, particularly considering low interest coverage and other factors.

(3) Some idea of the shaky condition of NII can be gained from the following: for *all* U. S. manufacturing, interest coverage was 8.24 in 1967, the latest year for which figures are available and for retail trade was 4.73. Even for the highly stable public utilities coverage was 3.56. Source: computed from U. S. Treasury, *Statistics of Income, 1967,* Table 2, pp. 18ff. Graham, Dodd & Cottle recommend minimum coverage of 7 for manufacturing, 5 for retail and 4 for utilities.

Conclusion: National B preferred to be issued in deal should be valued at $11.25 per share.

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* After deal. $6,844,000 divided by $1,529,000 (combined A + B Pfd. Div) (p. 17 and 21) = 4.45x

Pre deal $4,142,000 divided by $310,000 = 13x

3. *Summary: Value of National Securities Used in Deal.*

975,000 Nat'l. B Pfd. at $11.25 =	$10,968,750
2,511,173 Nat'l. Warrants at $1.50 =	3,766,760
Total value of Nat. securities used	$14,735,510

On basis of exchange terms per share:

1. Each share TSC Preferred gets:

0.6 National B at $11.25	$6.75
1 warrant at $1.50	1.50
	$8.25

2. Each share of TSC common gets:

0.5 National B at $11.25	$5.63
1.5 warrants at $1.50	2.25
	$7.88

VII. *Comparison of Values—Loss.*

	TSC
Total Common	1,852,603 shares
National owns	519,733
Non-National owned Common	1,332,870 shares
Total Preferred	951,513 shares
National owns	439,675
Non-National owned Preferred	511,838 shares

Values Compared—Non National TSC Holders

TSC Valued: (V6) TSC 1969 Adjusted for Extraordinary

1,332,870 TSC Common at $29.80	$39,719,526
511,838 TSC Preferred at $22.35	11,439,559
Value Given	$51,159,085
Value Received	14,735,510
Difference—Loss	$36,423,575

TSC Valued: (V6) 1969 Adjusted for NII Management

1,332,870 TSC Common at $34.80	$46,383,876
511,838 TSC Preferred at $26.10	13,358,972
Value Given	$59,742,848
Value Received	14,735,510
Difference—Loss	$45,007,338

TSC Valued: (V7) 1966-1968 TSC Average Earnings

1,332,878 TSC Common at $32.80	$43,718,136
511,838 TSC Preferred at $24.60	12,591,215
Value Given	$56,309,351
Value Received	14,735,510
Difference—Loss	$41,573,841

TSC Valued: (V7) 1967-1969 TSC Average Earnings 1969 Adjusted for Extraordinary

1,332,878 TSC Common at $34.40	$45,850,728
511,838 TSC Preferred at $25.80	13,205,420
Value Given	$59,056,148
Value Received	14,735,510
Difference—Loss	$44,320,638

TSC Valued: (V7) 1967-1969 TSC Average Earnings 1969 Adjusted for National Management

1,332,870 TSC Common at $36.40	$48,516,468
511,838 TSC Preferred at $27.30	13,973,177
Value Given	$62,489,645
Value Received	14,735,510
Difference—Loss	$47,754,135

Conclusion.

Comparison of values given up and received as attributable to TSC stockholders other than National shares that the non-National holders of TSC suffered a loss of between $36.4 and $47 million.

VIII. *List of Materials Noted or Referred to.*

Documents and exhibits obtained by plaintiff's attorneys from attorneys for defendants.

Moody's Manuals

Wall Street Journal

Commercial and Financial Chronicle

Bank & Quotation Record

Standard & Poor's Manuals and Industry Surveys

Fairchild's Manual—Financial Retailing

Moore & Schley, Inc., 1969 Retail Trade Industry

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E. E. Nemmers.

CHARTS A & B AND NOTE THERETO, TO PLAINTIFF'S BRIEF IN SUPPORT OF PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT AGAINST CORPORATE DEFENDANTS: CLOSING PRICES AND VOLUME OF TRANSACTIONS BY WEEKS FOR NATIONAL INDUSTRIES, INC. COMMON STOCK, FEBRUARY 7, 1969 TO NOVEMBER 7, 1969, AND MARCH 1, 1968 TO OCTOBER 4, 1968.

Chart A

National Industries, Inc. ("NII")

Closing Prices and Volume of Transactions
by Weeks (NYSE)

Week Ending February 7, 1969
to Week Ending November 7, 1969

Purchases of NII Common by NII and by Madison Fund, Inc.

Chart B

National Industries, Inc. ("NII")

Closing Prices and Volume of Transactions by Weeks
(AMEX and NYSE)

March 1-October 4, 1968

Purchases of NII Common by Madison Fund, Inc.

Notes to Charts A and B

CHART A
NATIONAL INDUSTRIES, INC. ("NII")
CLOSING PRICES AND VOLUME OF TRANSACTIONS
BY WEEKS (NYSE)
WEEK ENDING FEBRUARY 7, 1969
TO WEEK ENDING NOVEMBER 7, 1969
PURCHASES OF NII COMMON BY NII AND BY MADISON FUND, INC.

Week Ending (1)	NII Common Close (2)	Sales Volume (3)	NII Purchases of NII Common (4) (No. of Shares)	Madison Fund Purchases of NII Common (5) (No. of Shares)	NII or Madison Fund Purchases as Percent of Total Volume (6)	Notes (7)
2/7	21-3/4	47,800				(A) (B)
2/14	21	38,200				
2/21	19	53,100				
2/28	18-5/8	46,800				
3/7	17-3/4	43,200		4,500 at 17-3/4-19-1/8	10.4 %	(C)
3/14	16-5/8	28,100				
3/21	17	29,600				
3/28	17	49,200	4,200 at 16-16-1/4		8.5 %	(D)
4/4	16	14,500				
4/11	16-1/2	40,200		26,582 at 15-1/8-16-5/8	66 %	(E)
4/18	15-1/2	21,100		7,400 at 16-1/2	35 %	
4/25	14-5/8	51,300				
5/2	15-5/8	49,600				

[Notes follow Chart B]

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CHART A (CONT'D.)

Week Ending (1)	NII Common Close (2)	Sales Volume (3)	NII Purchases of NII Common (4)	Madison Fund Purchases of NII Common (5)	NII or Madison Fund Purchases as Percent of Total Volume (6)	Notes (7)
5/9	15-5/8	46,100				
5/16	14-5/8	56,600	2,000 at 15		3.5 %	(F)
5/23	14-1/4	55,000				
5/30	13-3/8	31,000				
6/6	13-1/4	34,000				
6/13	12-1/8	34,700				
6/20	12	39,800	7,300 at 12-1/8 3,800 at 12		29 %	(G)(H)
6/27	11-3/4	39,500	9,200 at 12		23 %	(I)(J)
7/4	12-1/4	20,000				
7/11	11	37,200	4,300 at 11		11 %	
7/18	10-1/2	33,900	800 at 10		2.3 %	
7/25	10	21,000	400 at 10		1.9 %	
8/1	10-7/8	52,800	18,800 at 10		35 %	(K)
8/8	10-1/8	24,000				
8/15	10-1/8	24,000	2,800 at 10		11.7 %	(L)
8/22	10-1/4	30,100				
8/29	11-3/4	32,500		10,000 at 10-1/4-11	30.7 %	(M)
9/5	10-5/8	34,900		9,800 at 10-5/8-11-1/4	28.2 %	
9/12	10-1/8	27,500		700 at 10-1/2	.07%	
9/19	10	25,800	2,000 at 10		7.7 %	
9/26	10	23,800				
10/3	9-7/8	34,400		5,000 at 9-1/2-9-7/8	14.7 %	

CHART A (CONT'D.)

Week Ending (1)	NII Common Close (2)	Sales Volume (3)	NII Purchases of NII Common (4)	Madison Fund Purchases of NII Common (5)	NII or Madison Fund Purchases as Percent of Total Volume (6)	Notes (7)
10/10	9-1/2	39,300		7,000 at 8-7/8-9-1/2	17.8 %	(N)
10/17	10-5/8	42,800		4,200 at 9-1/2	9.8 %	(O)(P)
10/24	10-3/8	60,600				
10/31	11-1/4	67,600				
11/7	10-1/4	39,500				
		1,521,000 shares	55,600 shares at a total cost of $637,512 (App. D)	74,682 shares at a total cost of $987,003 (App. B)	8.5%	15,000 share for $375,0 (Note

Combined Purchases:
145,282 shares for
$1,999,515

[Note: Col. (2), "NII Common Close", is taken from NII Request for Admissions of February 1, 1971. Admitted by Plaintiff April 5, 1971. Col. (3), "Sales Volume", is taken from financial publications. See App. A hereto. Col. (4), "NII Purchases of NII Common", is taken from Ex. A to the Joint Answer of NII and other Defendants. (App. D hereto) Plaintiff has been furnished with varying tabulations of such purchases, e.g., Exs. 421 and 427. Ex. A has been selected as the latest and presumably most authoritative document. Col. (5), "Madison Fund Purchases of NII Common", is taken from Ex. 3 to Objections filed by NII on or about 11-19-71. App. C hereto.]

CHART B
NATIONAL INDUSTRIES, INC. ("NII")
CLOSING PRICES AND VOLUME OF TRANSACTIONS BY WEEKS
(AMEX AND NYSE)
MARCH 1-OCTOBER 4, 1968
PURCHASES OF NII COMMON BY MADISON FUND, INC.

Week Ending	NII Common Close (AMEX)	Sales Volume	Madison Fund Purchases of NII Common (No. of Shares)	Madison Fund Purchases as Percent of Total Volume	Notes
(1)	(2)	(3)	(4)	(5)	(6)
3/1	17-7/8	58,100			
3/8	18-1/4	64,400			
3/15	18-3/4	51,000			(Q)
3/22	18-3/8	30,200	200 at 18	.7%	(R)
3/29	18-5/8	26,600	4,000 at 18-18-1/2	15 %	(S)
4/5	18-5/8	51,500	5,800 at 18-3/4-19	11 %	(T)
4/12	18-7/8	23,600			
4/19	20-1/8	109,600	10,000 at 18-3/4-20	9 %	(U)
4/26	21-3/4	72,800			(V)(W)
5/3	24	185,600	23,200 at 21-3/4-24-1/2	12 %	(X)
5/10	23-3/8	75,300			(Y)
5/17	23	72,600			(Z)
5/24	24-7/8	120,000	10,000 at 23	8 %	
5/31	25	166,100			
6/7	25-1/4	92,200			
6/14	24-3/8	75,100			
6/21	24-1/2	53,200	2,500 at 23-3/4-24	5 %	(AA)

[Notes follow this Chart]

CHART B (CONT'D.)

Week Ending	NII Common Close (AMEX)	Sales Volume	Madison Fund Purchases of NII Common	Madison Fund Purchases as Percent of Total Volume	Notes
(1)	(2)	(3)	(4)	(5)	(6)
6/28	23-1/4	29,500	2,500 at 22-7/8-24	8 %	
7/5	26-1/2	17,500			
	(NYSE)				
7/12	25-5/8	106,900			(BB)
7/19	24-1/8	61,800			
7/26	22-1/2	45,900	7,300 at 22-3/4-23-3/4	15.8%	
8/2	21-1/2	36,400	2,700 at 21-22-1/8	7.4%	
8/9	21-1/2	19,700			
8/16	21-1/4	46,500			
8/23	21	33,900			
8/30	21-1/2	31,300	6,800 at 21-21-1/4	21.7%	
9/6	22-3/4	36,000	3,400 at 22-1/8-23	9.5%	
9/13	22	32,600	5,500 at 22-3/8-22-1/2	16.8%	(CC)
9/20	20-5/8	36,300	2,000 at 21-1/2	5.5%	(DD)
9/27	21-5/8	66,400	9,200 at 20-7/8-21-1/2	15 %	(EE)
10/4	22-1/4	115,200	800 at 21-1/8	.7%	(FF)(GG)(HH)
		2,043,800 shares	95,900 shares at a total cost of $2,092,736 (App. C)	4.7%	

[Note: Col. (2), "NII Common Close" and Col. (3), "Sales Volume", taken from financial publications. See App. A hereto. Col. (4), "Madison Fund Purchases of NII Common", is taken from Exhibit 3 to Objections filed by NII on or about 11-19-71, App. C hereto.]

NOTES TO CHARTS A AND B

(A) On 1-20-69 (according to Exhibit 420) or 1-30-69 (according to Exhibit 427), NII accepted 15,000 shares of NII Common from Siegfried Susskind as payment of $375,000 on a note. NII Common was thus valued at $25.00 per share. The 1-20-69 NII Common high on NYSE was 21-5/8. On 1-30-69 the stock closed at 21-3/4. (NII Request for Admission of 2-1-71. Admitted by Plaintiff 4-5-71). Thus NII in effect purchased 15,000 shares of NII Common at about $3.25 per share over market.

(B) 1-30-69: NII agrees to acquire about 33% of TSC stock from Schmidt Defendants. Deal closed 2-7-69. (Admitted by NII Answer to Ct. I, ¶7, of Restated Complaint).

(C) During the 40 weeks listed in Chart A, NII or Madison made purchases of NII Common in 19 weeks. NII never purchased during a week in which Madisoh bought and Madison never purchased during a week in which NII bought.

(D) Of the 4,200 shares purchased this week, 1,000 were bought on 3-26-69 at 16-1/4. Reported NYSE high for day was 16-1/8. (App. A hereto)

(E) On Monday, 4-7-69, NII Common fell to 15-1/8, a 1969 low. (App. A hereto) Madison Fund purchased 8,300 shares that day. It made additional purchases every day that week and on first two days of following week. (App. C hereto)

(F) On Friday, 5-16-69, the Wall Street Journal reported NII earnings for first quarter 1969 at 6 cents per share, as compared

NOTES TO CHARTS A AND B

to 19 cents for first quarter 1968. On 5-15-69, NII purchased 2,000 NII Common.

(G) Hawthorn-Mellody Employees' Retirement Fund on or about 6-18-69 purchased 7,300 shares of National Common at $12.13. (Admitted by NII in its Answer (p. 55) to Count I, ¶14(n)(2) of the Complaint). NII Common paid no dividends. Hawthorn-Mellody had been acquired by NII in Fall, 1968.

(H) The Complaint, Count I, ¶14(n)(2), alleges that in 11 weeks in 1969, NII or Madison Fund purchases exceeded 10% of trading volume. Based on Exhibit A to the Answer (App. D hereto), their purchases exceeded 10% in 12 weeks.

(I) Of the 9,200 shares purchased, 1,000 were bought on 6-26-69 at 12. The NYSE high for the day was 11-5/8. (App. A hereto)

(J) The Complaint, Count I, ¶14(n)(2) alleges that in one week NII purchases were 47% of total market volume. Based on exhibits previously given to Plaintiff, NII purchased 9,500 shares in the week ending 7-4-69. This was 47.5% of the 20,000-share volume of that week. Exhibit A to the NII Answer (App. D hereto) shifts 9,200 shares to the week ending 6-27-69 when volume was 39,500 shares. (See Note preceding App. D hereto).

(K) The Complaint, Count I, ¶14(n)(2) alleges that in one week NII purchases were 78.5% of total market volume. Based on exhibits previously given to Plaintiff, the purchase of 18,800

NOTES TO CHARTS A AND B

shares by NII was in the week ending 8-8-69 and was 78.5% of the 24,000-share volume of that week. Exhibit A to the NII Answer (App. D hereto) moves this purchase to the week ending 8-1-69. (See Note preceding App. 2 hereto).

(L) On Friday, August 15, the Wall Street Journal reported first six-months' results for National at 18 cents per share as compared to 44 cents per share for the first six months of the prior year. On 8-11 NII purchased 2,800 shares at 10.

(M) In 1968, National acquired Nelson Sales Company in exchange for NII Common. Under the acquisition agreement Nelson stock-holders were to receive additional shares of NII Common if the average earnings of Nelson for a three-year period exceeded a specified sum. National Common was to be valued in part at the average of the 8/25-8/29/69 closing prices on NYSE. (Exhibit 449) On August 25, Madison purchased 500 shares of NII Common on NYSE; on August 26, 2,500 shares; and on August 28, 7,000 shares. Its purchases were over 30% of the week's total market volume. NII Common closed on August 29 at 11-3/4, up 1-1/2 over the close on August 22. (App. A hereto)

(N) On October 7, 1969, the Wall Street Journal carried a story that National and TSC were holding "exploratory talks" toward a merger. In the week preceding this announcement (ending October 3), Madison purchases amounted to 14.7% of the trading in NII Common on NYSE. On each of the three days following the

NOTES TO CHARTS A AND B

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NOTES TO CHARTS A AND B

story, Madison purchased National Common. It accounted for 17.8% of trading volume during the week ending October 10, and 9.8% of volume during the following week ending October 17.

(O) On 10-13-69 details of the acquisition plan were publicly announced by NII in the Wall Street Journal.

(P) On 10-16-69, TSC directors purportedly approved plan of acquisition by NII. (Joint Proxy Statement, p. 4)

(Q) On 3-12-68, NII acquired option to purchase 37% of Crescent Corporation, a manufacturer of laboratory equipment. (Exhibit 153)

(R) Initial purchase of NII Common by Madison Fund, Inc. Madison is a closed end investment company listed on NYSE. Bernard H. Barnett was, since 1962, a director. (Madison Fund, Supp. to Proxy Statement dated 2-11-72, App. B hereto) Barnett was NII Board Chairman (Jt. Proxy Statement, p. 44). On 8-1-67, NII employed Edward A. Merkle, President of Madison and a director since 1953, (App. B, p. 4), and gave him an option to buy 10,000 shares of NII at $7.25 per share. (Exhibit 409)

(S) See Note (X)

(T) See Note (X)

(U) See Note (X)

(V) On 4-25-68 Crescent directors voted to merge with NII. Crescent

NOTES TO CHARTS A AND B

Common, valued at $17.50 per share, to be exchanged for NII Common. NII Common to be valued at the average of the closing market prices during the two weeks preceding the week in which merger proxy materials (see (Z)) were mailed to Crescent shareholders. Crescent Preferred to receive, share for share, (the subsequently named) National Series B Preferred, convertible into 3/4 share of National Common. (App. D to Exhibit 153)

(W) In 1967, National acquired a 55% stock interest in Cott Corporation, a manufacturer of soft drinks. About 4-22-68, National proposed a merger of Cott and National. Each share of Cott was to be exchanged for .4 share of the (subsequently named) National Series A Preferred stock, convertible into 1.4 shares of National Common. (Exhibit 153, p. 6) The proposed NII-Cott merger was submitted to the stockholders in a 5-17-68 Joint Proxy Statement. (Exhibit 153) The Cott stockholders were not informed of Madison's ties to NII and of Madison's market purchases.

(X) First week of NII Common valuation period for Crescent transaction. (See (V) and (Z)) Madison purchased 5,000 shares of NII Common on NYSE on 4-29-68 and 18,200 shares on Friday, 5-3, in nine separate transactions. The purchase of 5-3 was 19% of Madison's total purchases for the year. The stock rose 2-1/4 points that day and all Madison purchases were made near the high for the day. National Common closed on 5-3 at 24, its highest since the week of 1-26-68. Further, Madison was a substantial

NOTES TO CHARTS A AND B

purchaser of NII Common in the weeks ending March 29, April 5 and April 19, 1969.

(Y) Second week of NII Common valuation period for Crescent transaction. (See (V) and (Z))

(Z) A Joint National-Crescent Proxy Statement dated May 17, 1968 (Exhibit 153) was mailed to Crescent Common shareholders about that date. (Ltr. Morency, counsel for NII to Lassers, 1-4-72, p. 2) (App. E hereto) It set an exchange ratio of .75 share of National Common for each share of Crescent Common. Madison ties to NII and Madison purchases of NII Common during the valuation period were not disclosed.

(AA) Madison continued to make substantial purchases of NII Common at various times after May 17 and continuing to June 18, 1968. The Crescent, Cott and National shareholders approved the merger on June 20, 1968.

(BB) On or about 7-5-68, National acquired about 53% of the stock of Hawthorn-Mellody, Inc., a large distributor of dairy products. (Exhibit 152, p. 4)

(CC) On or about 9-3-68 National proposed a merger of National and Hawthorn-Mellody. Each share of Hawthorn-Mellody Common was to be exchanged for a Warrant to buy NII Common plus $20.00 in market value of NII Common. The market value of NII Common

NOTES TO CHARTS A AND B

was to be determined on the basis of the average closing price of National Common on the NYSE during the two-week period preceding mailing of the Proxy Statement to the holders of Hawthorn-Mellody. The exercise price of the Warrant (subject to minor adjustments) was to be the average closing price of National Common during the same two-week period. (App. to Exhibit 152)

(DD) First week of NII Common valuation period for Hawthorn-Mellody transaction. (See (CC) and (FF))

(EE) Second week of NII Common valuation period for Hawthorn-Mellody transaction. (See (CC) and (FF))

(FF) A Joint National/Hawthorn-Mellody Proxy Statement dated 9-27-68 (Exhibit 152) was mailed to the Hawthorn-Mellody shareholders on or about October 1. (Ltr. Morency to Lassers, 1-4-72, p. 2) (App. E hereto) The Proxy Statement states that the exchange ratio had been fixed at .93 share of National Common for each share of Hawthorn-Mellody Common and that the exercise price of the Warrants was $21.40.

In the week ending September 20, Madison purchased National Common on NYSE on September 16 and 17. In the week ending September 27, Madison made purchases every day the market was open: 2,500 shares on Monday; 500 on Tuesday; 4,600 on Thursday; and, 2,600 on Friday. (The market was closed on Wednesday.) Total purchases were 10,200 shares for the week. These purchases amounted

NOTES TO CHARTS A AND B

to 15% of the total volume traded on NYSE during that week.

The September 27, 1968 Proxy Statement (Exhibit 152) did not inform Hawthorn-Mellody shareholders of the relationships of Barnett and Merkle to National and Madison, (see (R)), nor did it reveal the purchases by Madison of NII Common on NYSE.

(GG) On September 30, Madison made a purchase of National Common on NYSE, its last one in 1968. On October 1, 1968, National raised Merkle's salary from $2,500.00 per year to $12,000 per year.

(HH) On 10-3-68, National issued a Prospectus for $25,000,000 5-3/4% Convertible Debentures. (Exhibit 151) The Debentures were convertible into National Common on the basis of $24.00 per share. The Prospectus states the closing prices of National on NYSE at various times immediately preceding October 3. It did not state the relationship of Barnett and Merkle to NII and to Madison Fund, (see (R)) nor did it reveal that Merkle's salary had just been increased by National. Further, the Prospectus did not state that Madison had been purchasing NII Common in the weeks and months immediately preceding the issuance of the Prospectus. On October 3, 1968, Madison purchased $2,000,000 of said Debentures. (App. H hereto)

BEST COPY AVAILABLE

APPENDIX A

State of Illinois } ss.
County of Cook }

AFFIDAVIT OF WILLARD J. LASSERS.

Willard J. Lassers, being first duly sworn on oath, deposes and says:

1. I am one of the attorneys of record in Northway, Inc. against TSC Industries, Inc. et al., now pending in the U. S. District Court for the Northern District of Illinois as Case No. 69 C 2513.

2. With respect to Chart A, attached to said Motion for Summary Judgment, the information with respect to sales volume shown in column (3) was compiled by me from *The Commercial and Financial Chronicle* and similar financial publications.

3. With respect to Chart B attached to Plaintiff's Memorandum in Support of Its Motion for Summary Judgment against National Industries, Inc. ("NII"): the data shown in columns (2) and (3) with respect to NII closing prices by weeks on the American Stock Exchange and the New York Stock Exchange, and the data relating to sales volume by weeks were assembled by me from *The Commercial and Financial Chronicle* and similar financial publications.

4. During 1969, NII made purchases of NII Common at prices above the high prices on the day of purchase on the New York Stock Exchange as reported in standard financial publications. On the basis of Exhibit A to the Joint Answer of NII and other Defendants (Appendix D), such over market purchases are: (The high for day is shown in financial publications.)

Date of Transaction	Number of Shares Purchased	Purchase Price	High for Day on NYSE
3-26-69	1,000	16¼	16⅛
6-26-69	1,000	12	11⅝
	2,000		

On the basis of Exhibit 421, sent to Plaintiff prior to the filing of the Joint Answer, such over market purchases are:

Date of Transaction	Number of Shares Purchased	Purchase Price	High for Day on NYSE
5-21-69	2,000	15	14¼
6-27-69	2,800	12	11⅞
6-30-69	5,700	12	11⅞
7- 2-69	1,000	12	11¾
7-18-69	4,300	11	10⅝
	15,800		

5. (a) On April 7, 1969, National Common fell to 15⅛ on the New York Stock Exchange. This was a 1969 low.

(b) NII Common closed on the New York Stock Exchange on August 22, 1969 at 10¼. On August 29, 1969, it closed at 11¾.

(c) The January 20, 1969 NII Common high on the New York Stock Exchange was 21⅝.

6. The facts set forth in this Affidavit were assembled by me personally in the manner set forth above.

/s/ WILLARD J. LASSERS,
Willard J. Lassers.

Subscribed and sworn to before me this 28th day of September, 1972.

/s/ BONNIE BURKE,
Notary Public.

NOTE

EXHIBIT A TO PLAINTIFF'S REPLY BRIEF IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT AGAINST CORPORATE DEFENDANTS

As originally submitted, Exhibit A consisted of two sheets. The bottom sheet was a reproduction of a National Industries Exhibit, consisting of a chart attached to the Affidavit of Bruce Zalman.

Over this chart was a clear plastic overlay with a bargraph and references to Charts A and B, attached to Plaintiff's Reply Brief in Support of Its Motion for Partial Summary Judgment. References to red and blue lines in Exhibit A are references to lines drawn on the plastic overlay submitted to the District Court. All such lines, as well as all information originally contained in Chart A, appear on the following reproduction of Chart A.

OVERSIZE FOLDOUT(S) FOUND HERE IN THE PRINTED EDITION OF THIS VOLUME ARE FOUND FOLLOWING THE LAST PAGE OF TEXT IN THIS MICROFICHE EDITION.

SEE FOLDOUT NO 3

INVESTMENT COMPANY ACT RELEASE NO. 7280.

Administrative Proceedings Before the Securities Exchange Commission in the Matter of Edward A. Merkle.

In these proceedings pursuant to Section 9(b) of the Investment Company Act of 1940, Edward A. Merkle, chief executive officer of Madison Fund, Inc., a registered investment company, has submitted an offer of settlement. Under the terms of the offer, Merkle, solely for purposes of settling these proceedings and without admitting or denying the allegations in the order for proceedings, consents to an order finding that he committed certain violations as alleged in the order for proceedings on condition that the remaining allegations be dismissed, and suspending him from association with any investment company, broker-dealer or investment adviser for a maximum period of 60 days.

After due consideration, the Commission determined to accept the offer of settlement.

On the basis of the order for proceedings and the offer of settlement, it is found that, during the period from about December 1966 to August 1971, Merkle willfully violated and aided and abetted violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 17(a)(3), 17(d) and 48(a) of the Investment Company Act and Rule 17d-1 thereunder. Among other things, Merkle caused Madison Fund to purchase time certificates of deposit and place non-interest bearing demand deposits in various commercial banks in return for loans by those banks to Katy Industries, Inc., Missouri-Kansas-Texas Railroad Co. ("MKT"), and Southwestern States Management Company ("SSMC"), companies affiliated with Madison Fund and Merkle. In addition, in return for loans by certain banks to MKT and SSMC, Merkle caused Madison Fund to execute put options in favor of the banks,

under the terms of which the banks could require Madison Fund to pay on demand the unpaid balances of the loans and accept the pledged collateral in exchange. Merkle also caused Madison Fund to enter into numerous transactions involving portfolio securities on a joint or joint and several basis with Mad International Fund, Inc., an unregistered off-shore closed-end investment company of which Madison Fund was investment adviser and Merkle, chairman of the board. Merkle further caused Madison Fund to purchase 182,500 shares of National Industries, Inc. common stock and National convertible bonds in the principal amount of $2 million without disclosing that he was a salaried employee of National, had National common stock and stock options in his personal portfolio, and sold at least 8,100 shares of registered National common stock during the period of Madison Fund's purchases.

In support of his offer of settlement, Merkle represents, among other things, that he has never previously been disciplined in any proceeding involving any aspect of the securities business, in which he has been engaged for many years, that he has already suffered substantial adverse publicity, and that he has been named a defendant in a number of private damage actions based on the allegations herein.

In view of the foregoing, it is in the public interest to impose the maximum sanction specified in the offer of settlement.

Accordingly, IT IS ORDERED that Edward A. Merkle be, and he hereby is, suspended for a period of 60 days from being associated with any investment company, broker-dealer or investment adviser, such suspension to be effective immediately, and that the charges alleged in paragraphs II E.4, II F and II I of the order for proceedings be, and they hereby are, dismissed.

For the Commission, by the Office of Opinions and Review, pursuant to delegated authority.

/s/ RONALD F. HUNT
Ronald F. Hunt
Secretary

FILED
JUN 23 1975
MICHAEL RODAK, JR., CLERK

No. 74-1471

In the

Supreme Court of the United States

OCTOBER TERM, 1974

TSC INDUSTRIES, INC., a Delaware corporation, NATIONAL INDUSTRIES, INC., a Kentucky corporation, and TSC INDUSTRIES, INC. (formerly named NII, INC., and being the successor to the business, assets and corporate name of said TSC INDUSTRIES, INC.), NORTHWAY, INC., a Delaware corporation,

Petitioners,

vs.

NORTHWAY, INC., a Delaware corporation,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1974

No. 74-1471

TSC INDUSTRIES, INC., a Delaware corporation, NATIONAL INDUSTRIES, INC., a Kentucky corporation, and TSC INDUSTRIES, INC. (formerly named NII, INC., and being the successor to the business, assets and corporate name of said TSC INDUSTRIES, INC.), NORTHWAY, INC., a Delaware corporation,

Petitioners,

vs.

NORTHWAY, INC., a Delaware corporation,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 512 F.2d 324.

Otherwise, Opinions Below, Jurisdiction, and Statutes and Rules Involved are as stated in the Petition.

QUESTION PRESENTED FOR REVIEW

The sole question presented and available for review by this Court would be:

Whether the evidence in the record below, establishing without genuine controversy the omission of numerous admitted and uncontroverted facts from the proxy statement, evaluated in the light of the contents of the proxy statement and the governing regulatory policies, was sufficient to establish a violation of Rule 14a-9 as adjudicated by the entry of partial summary judgment on the issue of liability?

STATEMENT OF THE CASE

The facts and proceedings below are fully and fairly summarized in the opinion of the Court of Appeals (but not in the Petition), appended to the Petition at pages A1-A30, and reported at 512 F.2d 324.

REASONS WHY THE WRIT SHOULD BE DENIED

A. THE CASE TURNS WHOLLY ON ITS FACTS AND PRESENTS NO IMPORTANT QUESTIONS.

1. The Judgment Rests on Multiple Independent Grounds Founded on Specific Factual Omissions from this Particular Proxy Statement.

This case is not worthy of this Court's time and attention. The decision below turns wholly upon the facts. The judgment below rests solidly upon multiple grounds, each independent, separate, and adequate in itself to support the entry of partial summary judgment on the issue of liability. The Court of Appeals, in an opinion devoted heavily to an exposition of the admitted and uncontroverted facts, held without doubt or equivocation that the proxy

statement violated the disclosure Rules with at least four patently misleading omissions. They can be briefly summarized.

Prior reports of control. The proxy statement prominently presented the urgings of the TSC board of directors, advising its shareholders to vote for approval of the takeover by National. Yet not a single mention was made of the fact that a series of three official reports had been filed with the SEC by both TSC and National, only a matter of months before the proxy statement was mailed, in order to report that National may be deemed to be the parent of TSC and hence in control of the corporation. As the court below held, these facts, revealing that "both National and TSC thought it necessary to inform the Securities Exchange Commission that National could be deemed to be in control of TSC" . . . "were persuasive indicators that . . . National thus 'sat on both sides of the bargaining table' in setting the terms of the exchange" and their nondisclosure was therefore "materially misleading within the meaning of §14(a) . . . ." Pet. A13-14; 512 F2d, 333.

Key executive positions. The proxy statement presented the advice of TSC's management, counseling the shareholders to vote approval, without disclosing that National's president, Stanley Yarmuth, had been installed as Chairman of the Board of TSC, and had thereby become its Chief Executive empowered under its by-laws to supervise and control all TSC business. Nor was there any disclosure of the fact that National's executive vice president, Charles Simonelli, had been installed as Chairman of TSC's Executive Committee, with National's president as one of the Committee members. The judges below unanimously agreed "that the failure to include these facts was misleading since TSC stockholders were

relying on the TSC board of directors to negotiate on their behalf for the best possible rate of exchange with National." Pet A 13; 512 F. 2d, 333.

Undisclosed stock purchases. The exchange offered to the TSC shareholders gave them a package consisting of warrants to buy National common and of preferred shares convertible into National common. The market prices of National common in recent years were displayed, and emphasized by repeated references, in the advice to the shareholders, to "recent market prices" and "current market values represented by the securities being offered . . . ." But crucial facts bearing on these market prices were not revealed. During the last two year period of the market-price list, National and Madison Fund Inc., a large mutual fund, had purchased some 260,000 shares of National common. This purchase program amounted to some 8.5% of all market transactions in the stock in the nine months preceding the takeover. In addition, Madison Fund also purchased $2 million in National debentures convertible to common. Madison Fund's president, Edward Merkle, was carried on the National payroll at $12,000 per year for "being available" to National at least one day per month, and National's board chairman, Bernard Barnett, was a Madison director. Because shareholders "must be informed of circumstances which tend to indicate that the current selling price of the common stock involved may be affected by apparent market manipulations", the court found that these omissions "also violated Rule 14a-9 as a matter of law." Pet A 19; 512 F.2d, 336.

Market price of warrants. The proxy statement recited that the firm of Hornblower & Weeks-Hemphill, Noyes had rendered a favorable opinion regarding the fairness of the transaction to TSC shareholders, based in part on "the

substantial premium over current market values represented by the securities being offered to TSC stockholders." Prices and exchange ratios were supplied, inviting the shareholder to calculate his own substantial premium. The shareholders were *not* told that the Hornblower firm had also rendered an opinion predicting that the offered warrants, when issued, would sell at $3.50 rather than at the $5.25 price shown in the proxy statement. This disclosure would have reduced the apparent "substantial premium" by 89% for TSC common and 54% for TSC preferred. The Court of Appeals' common-sense conclusion is simple and succinct; "The materiality of the omission is obvious." Pet. A 18; 512 F. 2d, 335

Lending weight to these holdings of the court below, the SEC, as the responsible and expert agency in the field, independently reached the same conclusions, and advocated this judgment in its brief as *amicus curiae* in that court.

2. A Review of the Sufficiency of the Facts Would Serve No Useful Purpose.

The weight of these omissions, singly and in combination, is the sole issue open for review and the only real question that can be tendered to this Court by a petition for certiorari. The Court does not sit to review evidence, and does not write opinions to discuss specific facts, unique to the case at hand. A decision by this Court, analyzing the sufficiency of the voluminous evidence, could have no impact beyond the limits of this specific and isolated case.

There is no real question here of what the law is. The Petition makes a labored but vain attempt to concoct a legal question of the definition of materiality, based on a misinterpretation of the Court of Appeals' opinion, as we submit below, pages 7-9. Against this attempt, the decision below stands as a straightforward application of the standards laid down by this Court in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970), and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972).

3. Under Any Conceivable Test, Materiality Is Clearly Established by the Admitted Facts.

Even if some verbal fault could be charged to the lower court's restatement of this Court's test of materiality (which it cannot), and even if some difference in definition could be found which was not purely hypothetical, abstract, and lacking any capacity to decide real cases (which it cannot), such an issue would be irrelevant to the decision of this particular, concrete case. Under any plausible standard of materiality, the misstatements and omissions established in this record are clearly material. They concern the two most critical factors in the shareholder's decision: (1) a conflict of interest tainting the advice given by his board of directors and management, and (2) the unreliability of the market prices for the securities offered to him in the exchange.

Petitioners necessarily concede that "in many cases misstatements or omissions may be so clearly material that there is no need nor occasion to focus on the standard of materiality." Pet. 10. If any misleading omission can ever be ruled to be material as a matter of law in a proper case, then this is that case. Thus the Petition, at best, is an invitation to useless *obiter dictum*.

4. Whatever the Standard, the Result Reached Below is Compelled by this Court's Mills Decision.

The irrelevance of the Questions Presented to the result in this case is emphatically demonstrated by a comparison of the facts here with the facts and result in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970). The match is complete. There, as here, a partial summary judgment on liability was entered upon a showing that needed votes for a merger had been obtained through a proxy statement offering the favorable advice of the target's board of directors without disclosing a control relationship, involving a conflict of interest, previously reported to the SEC. This Court unanimously held that liability is established by such a showing, and chose not to disturb the lower courts' ruling that the omissions were material as a matter of law, without the necessity of an impractical trial on "the probabilities that the merger would have received a sufficient vote even if the proxy statement had not been misleading." 396 U.S., 380. The identity of facts here requires an identical result, with no need for inquiry into the reasoning of the court below. It is not the function of review to police the language of lower courts when the right result has been reached.

B. THE QUESTIONS PRESENTED IN THE PETITION HAVE NO BASIS IN THE RECORD.

1. The Opinion Below Announces No New or Novel Test of Materiality.

The Petition is based wholly upon a misreading of the opinion below and a misinterpretation of the Court of Appeals decision. That court did *not* say that materiality "requires only a showing of relevancy and possible importance to 'some few stockholders,'" as petitioners urge in

their first Question Presented (Pet. 2). On the contrary, the Court of Appeals explicitly "concluded that the proper test of materiality is whether the omitted fact is 'of such a character that it might have been considered important by a reasonable shareholder who was in the process of determining how to vote.'" Pet. A11-12; 512 F.2d, 332. This test is directly quoted from this Court's decision in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970) and as reiterated and reconfirmed in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 154 (1972).

Two corollaries are implicit in this Court's test. First, since the *reasonable* shareholder controls, it follows that materiality exists despite the fact that *some* shareholders may regard the fact as irrelevant or unimportant, so long as the average, typical, reasonable shareholder might consider it important. Thus, the Court of Appeals correctly observed that this Court's test will "reach facts which may be relevant for some, but not for others." Pet. A9; 512 F.2d, 331.

The second corollary is implicit in the word "important" in this Court's test. The omitted fact need not be of such overwhelming significance to the reasonable shareholder that it will necessarily reverse his vote; it is enough that he might consider it *important*, whether or not it is *determinative* of his vote. Accordingly, the court below was merely restating the obvious in observing that a fact is nonetheless material although it might not be determinative of the votes of most shareholders, and even though only "for some few stockholders these same facts could be determinative." Pet A9; 512 F.2d 330. This Court made the same observation in a footnote elaboration of its materiality test in *Mills* itself, pointing out that importance is enough, regardless of whether a reasonable stock-

holder would still have voted the same way without the nondisclosure:

> "Thus, the failure to make such a disclosure was found to be a material defect 'as a matter of law,' thwarting the informed decision at which the statute aims, *regardless of whether the terms of the merger were such that a reasonable stockholder would have approved the transaction* after more careful analysis." 396 U.S., 384 (emphasis added).

The Petition seizes upon two phrases wrenched from their context, where they served merely to restate the obvious and inherent corollaries to this Court's test of importance to a reasonable shareholder. Isolating "some few stockholders" and "relevant for some, but not for others," the Petition escalates them into a supposed "new" and "novel" test of materiality, offered as the principal Question Presented for review by this Court. This pretended Question evaporates with a fair reading of the Court of Appeals opinion.

2. Petitioners' "Propensity" Test Finds No Support in Mills and Contravenes its Holding.

The Petition also fails in its effort to devise some question of law for review by manufacturing two separate and conflicting tests of materiality with the catch phrases "might have" and "significant propensity." The phrases are taken from consecutive sentences in Mr. Justice Harlan's opinion in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S., at 384, and the argument assumes that he was at once announcing two conflicting and contradictory tests. His words, fully and fairly read, put that assumption to rest. Materiality, he said, "embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was

in the process of deciding how to vote. *This* requirement that the defect have a significant *propensity* to affect the voting process . . ." 396 U.S., 384 (emphasis added to "This") Thus the catch phrases are merely synonyms, not contradictory standards, and the "significant propensity" is itself established by the "might have been considered important" test.

Mr. Justice Harlan, a consummate practitioner of the careful lawyer's art, was not indulging in loose talk. He was addressing directly the question before him: What effect on the voting process must be shown to establish liability for misstatements or omissions in a proxy statement? His answer is plain. The "significant propensity" required is established when the defect "might have been considered important by a reasonable shareholder." There is no need to engage in "the impracticalities of determining how many votes were affected" nor to require "proof of whether the defect actually had a decisive effect on the voting." 396 U.S., 385.

In this light, petitioners' "significant propensity" test is revealed as a subtle distortion of Justice Harlan's phrase. Through repetition out of context, the words are loaded with a connotation requiring appraisal of the probabilities that the outcome of the voting process would have been reversed. Petitioners would invert this Court's test to require instead, as they state, "that the omission or misstatement is likely to alter the outcome of shareholder voting", (Pet. 13), and to require "a trial on the issue of materiality" so misdefined. Pet. 16. Just such a trial "of the probabilities that the merger would have received a sufficient vote even if the proxy statement had not been misleading" (396 U.S., 380), had been ordered by the appellate court in *Mills*. This Court reversed.

In the guise of materiality, rather than causation, petitioners' "propensity" test demands a factual finding on the probability of a different outcome in the overall shareholder vote, in direct contravention of *Mills*. It is this distorted "propensity" test, advanced by petitioners, which the Court of Appeals rejects, not Justice Harlan's propensity which inheres in an omission that might have been considered important by a reasonable shareholder.

3. The Supposed Conflict Among the Circuits Is Nonexistent.

Petitioners' supposed conflict among the circuits disappears with the revelation of their distortion of "significant propensity." The court below was not disagreeing with the Second Circuit in its discussion of the "propensity" test, but was rather rejecting petitioners' unique argument. Neither the Second Circuit nor any other has accepted petitioners' test, and no conflict exists.

Judge Friendly in the *Gerstle* case offered not the slightest hint that he would require a trial to determine whether the misstatement was "likely to alter the outcome of shareholder voting" (Pet. 13), whether viewed prospectively or retrospectively, after the fact. On the contrary, he sustained the entry of summary judgment for plaintiff on the issue of liability, on the ground that the omission was material as a matter of law. *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2nd Cir. 1973).

The only difference between Judge Friendly's views and the views of Judge Swygert in the opinion below concerns a matter of verbal preference: Whether the materiality test should be expressed with "might", in accordance with this Court's phrasing in *Mills* and *Affiliated Ute Citizens*, or with "would", as Judge Friendly prefers. The differ-

ence, if any, is purely a matter of emphasis. Judge Swygert prefers "might" in order to emphasize that there is no need for evidence showing an actual impact on the vote of the shareholders as a whole, as *Mills* held, reversing the decision of a panel on which he sat. Pet. A10 n. 13; 512 F.2d, 331 n. 13. Judge Friendly prefers "would" to emphasize that the omission must not be trivial, (478 F.2d 1302), again as *Mills* held. But neither Circuit emphasized one aspect to the exclusion of the other, and of course Judge Swygert put "trivial" omissions aside.

The root question of materiality is whether the omitted fact is important enough that it ought to be disclosed to investors. Congress aimed at the solicitation, not the merger. Whether the proxy statement made the full and fair disclosure required by congressional policy does not depend upon the probability that the merger would have failed without the omission, nor is deceitful solicitation immunized by the probability that truth would also have succeeded. If the proxy solicitation (not the specific omission) produced votes essential to merger, there is no need to inquire further. This is the point of *Mills,* missed by petitioners.

Thus the issue is not a matter of factual probability or prediction of votes; "might" and "would" in this context do not describe a factual burden of proving what would or did actually happen. Rather, the words are used to express the requirement that the omitted fact most be of such a character as to be important to a reasonable shareholder. The question is not factual probability but permissibility within the limits of ordinary reason. It is in this sense that the degree of relevancy is the appropriate test of materiality. See opinion below, Pet. A10; 512 F.2d, 331. For this specific purpose, any possible difference between the verbs "might" and "would" is gossa-

mer, too ethereal, and hypothetical to carry any consequence in the decision of concrete cases.

The Second Circuit in *Gerstle,* under its "would" preference, found some omissions to be material as a matter of law, and others not. The Seventh Circuit below, preferring "might", also found some omissions material, and one not. There is no foundation for believing that the result in either case would have been affected in the slightest degree by a change in the tense, voice, or mood of the verb. Word choices that have no practical capacity to decide concrete cases are not the proper business of this Court. It would be shoveling smoke, in Learned Hand's phrase, to engage in this abstract and purely grammarian debate.

C. OTHER GROUNDS, NOT RELIED ON BY THE COURT BELOW, WOULD REQUIRE AFFIRMANCE OF THE JUDGMENT.

1. The Particular Facts Omitted Are Material as a Matter of Law Since They Are Singled Out by the Securities Laws as Critically Important.

A decision by this Court, choosing between "would" and "might", would have no decisional power in this case or any other. Beyond the reach of semantics, the judgment below is solidly grounded on facts, admitted, established, and plentiful. And beyond the four corners of that opinion, there are still other grounds which would compel affirmance.

Materiality under the securities laws does not depend exclusively upon the prevailing opinions of reasonable shareholders or their expectations in a vacuum. Many may not know what it is they need to know, and their

expectations are fed by the statutory scheme. Thus whether a fact is material as a matter of law may be properly determined by the circumstance that the law, as laid down by Congress and the SEC, has singled out that fact for special treatment and specific attention.

Here Congress has concluded that control of a corporation is a matter of such overwhelming importance to the investing public as to require immediate and special reports, under criminal penalties, whenever there is a change in control, by both the person acquiring control and by the issuer of the the affected security. To harmonize and effectuate the statutory scheme as a whole, any event which is so important as to trigger such special reports under §13 of the 1934 Act must be viewed under §14 as material as a matter of law.

Under the same principle, petitioners' nondisclosures of the major purchases of National common by the issuer and an affiliated investment fund are material as a matter of law, since Congress and the SEC have singled out such purchases as the subject of special prohibitions and regulations. See Rule 10b-6(b), and §9(b), Securities Exchange Act of 1934, 15 U.S.C. §78(i) (1934). And here the SEC found nondisclosure of such purchases by the Fund to be important enough to be the subject of suspension proceedings against its president. *In re Merkle,* SEC Inv. Co. Release No. 7280 (July 19, 1972).

Whatever uncertainties may confront the author of a proxy statement in other situations, he could have no room for doubt about what should be included in this instance. Both corporations issuing the joint statement had filed special reports only months earlier, to report a change in control. National was fully aware of its

stock purchases, and of those made by its employee also serving as president of Madison Fund. Any decision by this Court, refining the guidelines of its materiality test, would be irrelevant to this case and others where the regulatory scheme as a whole makes clear beyond peradventure the importance and materiality of the fact.

2. Affirmance Would Be Required on Alternative Grounds, Not Adopted Below, Involving No Element of Materiality.

In any event, the whole question of materiality is completely irrelevant under either of two alternative and adequate grounds of decision, not adopted by the court below. First, under Delaware law, as the opinion below intimates but declines to decide in view of the adequacy of other grounds, the board of directors' vote by less than a majority was insufficient to authorize any vote by the shareholders. It follows that *any* solicitation of proxies was misleading and deceitful, regardless of the contents of the proxy statement. Second, the SEC has forbidden the use of a proxy statement which does not directly state any change in control which has occurred, as petitioners had here reported to the SEC. This nondisclosure constituted a direct violation of Rule 14a-3 (Pet, A5, n. 8; 512 F.2d, 329 n. 8), which embodies no requirement of materiality. If certiorari were granted, the lower court's erroneous failure to add this ground of decision to the many others it adopted would suffice for affirmance with no need for consideration of any question of materiality as tendered by the Petition. In short, the Questions Presented are not necessary to decision and thus are not squarely raised by this case.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1471

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.)
Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,
Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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NORTHWAY, INC., A DELAWARE CORPORATION,
Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The determinative differences between the "significant propensity test" enunciated by this Court in *Mills* and the quite different test devised by the Seventh Circuit below cannot be sloughed off. The Seventh Circuit expressly articulated a test of materiality significantly at odds with that adopted by other Courts of Appeal and carefully distinguished its own standard from that stated by the Second Circuit in *Gerstle* and the Fifth Circuit in *Smallwood*. It then proceeded to apply its own test by which "relevancy alone is the critical test of materiality", thereby expressly rejecting application of the *Gerstle* and *Smallwood* test and Mr. Justice

Harlan's concept stated in *Mills* that a material omission must have a "significant propensity to affect the voting process." Accordingly, the Seventh Circuit, applying its relevancy test, found four complained of omissions to be "material", each of which separately or collectively simply could not be found material on summary judgment under the *Gerstle* and *Smallwood* test.

Because of its significant departure from the test articulated in *Mills*, *Gerstle* and *Smallwood*, the Seventh Circuit's test, if left standing, will perpetrate a profound injustice upon the Petitioners herein and, in the future, will have a significantly undesirable effect on the outcome of similar litigation in the Seventh Circuit. Proxy statements will be required to spell out substantial additional material which is "relevant" but nothing more. This is counterproductive to the achievement of clear, concise proxy statements limited to essential elements for shareholder understanding. Under the Seventh Circuit's test this Proxy Statement becomes unlawful and a multi-million dollar transaction is vitiated even though no reasonable shareholder was or should have been misled as to the material elements of and surrounding the transaction.

A.

This Case Poses an Important Question of Federal Securities Law, Not Merely a Fact Controversy.

To say that the Seventh Circuit's decision below is a "straightforward application" of *Mills* (Br. 10) distorts *Mills*. Respondent would disregard the expressed intent of this Court, and would deny the normal, clear and obvious meaning of this Court's phrase, "significant *propensity* to affect the voting process." Mr. Justice Harlan indeed took the matter more seriously, choosing the word "propensity" (which Webster's Third New International Dictionary defines as a natural inclination, innate or inherent tendency), and for *special* emphasis italicized and qualified that word with the additional word "significant".

For the Seventh Circuit now to make "relevancy alone" the "critical test of materiality" (A-10, note 13) drastically alters the rules of the game. Necessarily, "significant propensity" excludes from the concept of materiality some relevant facts and limits "material" information to those facts which directly pertain in a meaningful way to the issue being presented to the shareholders.

Nothing in *Mills* broadens the concept of materiality to comprehend all relevant facts regardless of significance. "[S]ignificant propensity" recognizes that, with causation presumed, materiality becomes more important. "[S]ignificant propensity" filters out what "relevancy" would require—omissions too insignificant to have probable impact on the voting process. The Seventh Circuit would destroy the filter.

B.

The Conflict Among the Circuits Is Clear and Important.

To say that the only difference between the Seventh Circuit and others is one of "verbal preference", favoring the word "might" over the word "would", is to lose sight of the forest for the trees. The inter-circuit conflict is basic and does not turn simply on the use of the words "might" and "would", at times used simply as convenient nametags for the very different tests applied.

The Second Circuit, by Judge Friendly in *Gerstle*, states in rejecting a "might" standard that "[w]hen account is taken of the heavy damages that may be imposed, a *standard tending toward probability* rather than toward mere possibility is more appropriate" (Emphasis added). The Fifth Circuit in *Smallwood*, rejecting the "might" test, said there is no evidence of any desire by this Court to "relax the standard of materiality to a mere possibility of influence on a reasonable investor, a standard implied by the word 'might.'" In marked and avowed contrast, the Seventh Circuit expressly rejected Judge Friendly's "standard

tending toward probability", stating as its reason that "once an element of probability becomes a part of the materiality test, a mere showing of relevancy of omitted facts is inadequate to establish a violation of 14a-9 or 10b-5" (A-10, note 13).

The conflict among circuits is whether materiality is to be equated simply with relevancy or limited to those facts which are of sufficient significance to have a *probable* impact on the shareholders' decision. Despite Respondent's protestations to the contrary, the test of materiality actually used by the federal courts has a very real "practical capacity to decide concrete cases" and is plainly not what Respondent dubs a "grammarian debate" (Br. 13).

Take *Smallwood,* for instance. *Smallwood* involved an omission in a merger proxy statement of the fact that Albert Range, who was an officer of Pearl (the merging company), was promised a stock option of 25,000 shares by the Board Chairman of Southdown, the surviving company. Relying on *Mills,* the Fifth Circuit held this omission not material as a matter of law in light of other disclosures which were made that "Range was to become a director of Southdown, that he was to be employed under a written contract for $75,000 annually and that Southdown had a qualified stock option plan." The Fifth Circuit said that "Although Pearl shareholders were not advised of the full extent of the merger's possible value to Range, they were 'sufficiently alerted' to Range's interests 'to be on their guard' " 489 F.2d 579, 604.

The Seventh Circuit, under its test, would have been compelled to reach a contrary conclusion on the *Smallwood* facts, since the omitted fact was clearly relevant and not trivial. Indeed the facts omitted in *Smallwood* were of greater consequence than the omissions in question here.*

* Respondent mistakenly asserts that the Seventh Circuit, under its test, also found one omission not to be material. However, the claimed omission, *i.e.* National's control over TSC, was expressly found not to be "a fact" but instead to pose an issue of fact about which there was "a bona fide dispute" under Rule 56 F. R. C. P. (A6).

C.

Mills' Facts Differ Basically From Factual Issues in This Summary Judgment Record.

To assert that, whatever the standard of materiality, the Seventh Circuit's result here is compelled by this Court's decision in *Mills* because "the match is complete" between the facts in *Mills* and the facts here (B. 7), is just a last-ditch argument which ignores the obvious and compelling differences between the facts here and in *Mills.* Those significant factual differences and disputes left Judge McLaren no choice but to deny Respondent's motion for partial summary judgment (A36-38).

It was not this Court* but the Seventh Circuit which held the *Mills'* 108-page proxy statement inadequate in describing fairly the proposed merger between Auto-Lite and Mergenthaler. 403 F.2d 429, 433-5 (7th Cir. 1968). On page 2 of that proxy statement it was stated in bold type that the Board of Directors of Auto-Lite believed the merger to be "fair and equitable to the shareholders of Auto-Lite". However, buried on page 23 was the fact that four of the eleven Auto-Lite directors were also directors of Mergenthaler. Nowhere was it admitted that seven of the Auto-Lite directors were Mergenthaler's nominees or that the remaining four directors were "kept" board members who continued to serve only at the pleasure of Mergenthaler and American. Except for a passing reference on page 2, the discussion of Mergenthaler's 54% ownership of Auto-Lite also appears on page 23. The Seventh Circuit there held that "under the circumstances the board was not free to state its recommendation and opinion favoring the merger without giving *similar emphasis* to the relationship between the directors and the other party to the bargain" [Emphasis added] 403 F.2d at 434.

* 396 U.S. at 381 n.4.

In basic contrast, in this case Judge McLaren held that:

> "Unlike the proxy statement dealt with in *Mills*, the joint proxy statement complained of here gives *similar emphasis* to the board's recommendation, National's equity interest in TSC and the number and some of the positions of National's nominees" [Emphasis added] (A37).

All of the information referred to by Judge McLaren was printed under headings of equal size on pages 6-7 of the Proxy Statement and those pages are reproduced as an Exhibit to the Petition. The sharp contrast between the essential facts in *Mills* and the facts Judge McLaren evaluates in this partial summary judgment record illustrates the difference between misleading statements and omissions which have a "significant propensity to affect the voting process" and those omissions which cannot be so classified. In *Smallwood* the Fifth Circuit found the omission of information about the stock option was not material as a matter of law and, at the same time, correctly observed that the omission could be found to be material after trial by the jury. 489 F.2d 604-5. Likewise here.

D.

Materiality Test Is Crucial in the Seventh Circuit's Decision Improperly Foreclosing a Trial of Disputed Fact Issues.

Respondent also asserts that the summary judgment record so adequately and clearly establishes the materiality of the complained of omissions as a matter of law that a departure from the *Mills* principles by the Seventh Circuit in this case would be of no consequence. From this Respondent concludes that the Petition is "an invitation to useless *obiter dictum*" (Br. 6). The Seventh Circuit's opinion dooms this approach and shows clearly that the test of materiality utilized was crucial to the result which the panel reached.

Judge McLaren had denied Respondent's motion for partial summary judgment by applying the "significant propensity" test in reliance on *Mills*. In order to show the District Court's judgment should be reversed, the Seventh Circuit first was compelled to reject what Judge Swygert called the "stricter propensity test" (A8) which had been followed by Judge McLaren. Next, the Court of Appeals expressed and adopted its "might have" test, which it recognized would comprehend "many facts" not coming within the significant propensity test. The detailed discussion of the different tests of materiality in the Seventh Circuit opinion, and its clear rejection of one and adoption of the other, is repugnant to Respondent's suggestion that the choice of tests is mere *dicta* (A7-13). Had the Seventh Circuit thought the omissions were material as a matter of law regardless of the standard used (Br. 6), there would have been no occasion for the panel's detailed analysis and emphasis on the test of materiality and its express rejection of the previously articulated standard.

It was the adoption of the "might have" or "relevancy" test which enabled the Court of Appeals first to isolate and then to find material undisclosed facts which, under the "significant propensity" test, would, as in *Smallwood*, "be viewed as unnecessary detail because stockholders were sufficiently alerted * * * to be on their guard" by the disclosed facts. Similarly, it was the adoption of the relevancy test which enabled the Seventh Circuit to determine the materiality of the various claimed omissions, contrary to Judge McLaren, without benefit of trial, and hence produced an abuse of the summary judgment device. Thus, even though relevant, the undisclosed facts concerning the purchases and value of National's securities could meet the "significant propensity" test for materiality only if after trial, there was evidence to establish collusion, manipulation of the market and distortion of value.

E.

SEC's Post-Facto Amicus Position Is Neither Timely Nor Persuasive.

Respondent seeks to reinforce its contention that the facts omitted in the Proxy Statement were "material" by relying on the *amicus curiae* brief filed in the Seventh Circuit by the SEC, "the responsible and expert agency in the field" (Br. 5). However, the SEC gave no support to the Seventh Circuit's new test of materiality. In addition, as this Court noted in *United Housing Foundation, Inc.* v. *Forman* (decided June 16, 1975, Slip Opinion, p. 19, note 24), the SEC's views are not entitled to much weight where the SEC does not speak with a single and consistent voice. Here the Commission has been singing more than one song.

In 1969 and now the SEC pointedly urges that prospectuses avoid unnecessary detail. Currently, Guide No. 5 of the SEC's Guides for Preparation and Filing of Registration Statements, Securities Act Release #4936, as amended states:

> "In order to make prospectuses more readable and understandable, and therefore more useful, Registrant should limit their length and complexity by careful organization of the material, . . . and the avoidance of . . . *unnecessary detail.*" [Emphasis added]

The SEC's Division of Corporation Finance, which examined and cleared the Proxy Statement in November, 1969, did not regard as material the factual matters later claimed to be material omissions in the SEC's *amicus curiae* brief. That brief was signed by members of the SEC's Office of General Counsel late in 1974. No doubt the Division in 1969 sought to avoid requiring unnecessary detail. Manifestly, the General Counsel's Office had nothing to do with the clearance of the Proxy Statement—five years before. The additional information which the SEC *amicus curiae* brief below argued to be "material" fits

neatly within the scope of "unnecessary detail". Its inclusion is plainly not conducive to the preparation of clear, concise and simple registration or proxy statements (Pet. 9-13).

Respondent complains that no mention was made of the fact that "a series of three official reports had been filed with the SEC by both TSC and National, only a matter of months before the Proxy Statement was mailed, in order to report that National may be deemed to be the parent of TSC. . . ." (Br. 3). Omission of any reference to those prior SEC filings was argued to be material in the SEC brief and found to be material as a matter of law by the Seventh Circuit. Yet, the staff of the Division of Corporation Finance, with whom these filings were made and who plainly must have been aware of them when they reviewed and cleared the Proxy Statement, did not regard those prior filings as sufficiently important to require any reference to them in the Proxy Statement.

In light of the plain and prominent disclosures in the Proxy Statement of the operative facts upon which the possibility of control by National existed (*i.e.*, National's 34% stock ownership of TSC and five National nominees on TSC's Board), this determination of the Division of Corporation Finance is far more consistent with the Commission's published admonition against the inclusion of "unnecessary details" than the *amicus curiae* brief filed five years later by another Division of the Commission having no past or present responsibility in the clearance of proxy material.

CONCLUSION.

The Petition for Writ of Certiorari should be granted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975.

No. 74-1471

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.), A DELAWARE CORPORATION,

Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' BRIEF.

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IN THE

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OCTOBER TERM, 1975.

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TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.), A DELAWARE CORPORATION,

Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' BRIEF.

This is an action under the Securities Exchange Act of 1934 ("1934 Act") and related rules of the Securities and Exchange Commission ("SEC").

Petitioners (hereinafter "TSC" or "National") request that this Court reverse the decision and judgment of the United States Court of Appeals for the Seventh Circuit (Chief Judge Swygert) which in turn had reversed, on interlocutory appeal pursuant to 28 U. S. C. § 1292(b), the denial by the United States District Court for the Northern District of Illinois (Judge

Richard W. McLaren) of Respondent's motion for partial summary judgment as to the liability of Petitioners. The other defendants, known collectively as the "Schmidt defendants," have no interest in the outcome of this petition.

OPINIONS BELOW.

The opinion of the Court of Appeals is reported at 512 F. 2d 324 (7th Cir. 1975); a copy is included as Appendix A to Petitioners' Petition for Writ of Certiorari. Judge McLaren's Memorandum Opinion and Order of May 21, 1973, denying partial summary judgment as to the liability of Petitioners TSC and National, is reported at 361 F. Supp. 108 (N. D. Ill. 1973); a copy is included as Appendix B to the Petition for Writ of Certiorari. Judge McLaren's Memorandum Opinion and Order of August 10, 1973, amending the foregoing Order of May 21, 1973, is unreported; a copy is included as Appendix C to the Petition for Writ of Certiorari.

JURISDICTION.

The judgment of the Court of Appeals for the Seventh Circuit was entered March 5, 1975. This Court's jurisdiction is invoked under 28 U. S. C. § 1254(1).

STATUTES AND RULES INVOLVED.

The following statutes, rules and regulations are involved in this case:

Securities Exchange Act of 1934, § 14(a), 15 U. S. C. §78n(a).

Securities and Exchange Commission, Rules 14a-9 and 405(a), (f), (n), 17 C. F. R. §§ 240.14a-9, 230.405(a), (f), (n).

Federal Rules of Civil Procedure, Rule 56(a), (b) and (c).

Because the foregoing provisions are lengthy, the pertinent text is set forth in the Appendix to this Brief (a to d).

QUESTIONS PRESENTED FOR REVIEW.

1. Whether "materiality", under the federal securities laws' prohibition against materially false or misleading statements or omissions, requires only a showing of relevancy and possible importance to "some few stockholders," as the Seventh Circuit held, or whether it requires a stronger showing of "significant propensity" to affect shareholders' judgment as this Court stated in *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970).

2. Whether the Seventh Circuit misused summary judgment, and hence improperly foreclosed TSC and National from a trial as to the issue of the materiality of the complained of omissions, by finding such omissions to be material as a matter of law.

STATEMENT OF THE CASE.

Preliminary Comment:

Six years ago on November 12, 1969 Petitioners National Industries, Inc. ("National") and TSC Industries, Inc. ("TSC") issued an 80-page joint Proxy Statement to their respective shareholders (A. 259). Respondent Northway, Inc. ("Northway") was a TSC shareholder. By the Proxy Statement the managements of the two companies sought their shareholders' approvals for the sale of substantially all of the assets of TSC to a National subsidiary in exchange for shares of National Preferred Stock and National Warrants.

On December 4, 1969, the day before the scheduled shareholders' meetings, Northway filed this derivative action attacking the sufficiency of the Proxy Statement (A. 1). Northway

alleged numerous violations of the federal securities laws and related rules and regulations of the SEC. Northway demanded a jury trial and requested injunctive relief to bar the proposed transaction, but Northway never so moved.

On March 6, 1972, Northway filed an Amended, Restated and Supplemental Complaint seeking money damages, restitution and dissembling of the consummated transaction by rescission and other equitable remedies. National and TSC denied its material allegations and sought an adjudication of non-liability. For easy cross-reference, the allegations of the Amended Complaint are fully reproduced as part of the Joint Answer (A. 3).

The relevant proceedings below culminating in this Court's review of the Court of Appeals' judgment reversing the District Court's denial of partial summary judgment are more fully developed hereinafter.

The Parties:

Northway is a private Delaware holding company organized by an individual investor to hold his investments, including 200 shares of TSC (A. 9, 123-24).

TSC was a publicly-held Delaware corporation whose Common Stock and Preferred Stock were listed on the New York Stock Exchange (A. 9, 12). TSC was a retail merchandiser whose principal businesses were the sale to farmers of repair and replacement parts for farm machinery and related farm goods and also the operation of retail self-service stores in the midwestern states. TSC, with approximately 4,400 employees, reported consolidated assets of $68.9 million as of mid-1969 and net sales for fiscal 1968 of $165.2 million (A. 280, 299-305, 313).

National is a diversified, publicly-held Kentucky corporation whose Common Stock and Preferred Stock are listed on the New York Stock Exchange and whose Warrants are listed on the

American Stock Exchange (A. 11). National's products and services mix consists of consumer products, industrial products, retailing, energy products and services and includes among its lines of businesses dairy and ice cream products, soft drink products, retailing, distribution and marketing of petroleum products and steel service centers. As of mid-1969, with approximately 8,000 direct and subsidiary employees, National reported consolidated assets of $235.4 million and for calendar 1968 net sales and operating revenues of $341.3 million (A. 275, 285-98, 313).

The Transaction:

In February, 1969 National had purchased a substantial minority interest in TSC from Charles E. Schmidt, TSC's founder, and his family (A. 379). By October, 1969, through subsequent additional purchases, National had increased its interest in TSC to approximately 34% of TSC's voting securities.

In substance, the transaction described in the Proxy Statement was a taxable swap of listed securities for the remaining 66% of TSC's voting securities. Each TSC stockholder received National securities for his TSC stock, the exchange ratio being .6 share of National Series B Preferred Stock and one National Warrant for each share of TSC Series 1 Preferred Stock. Each share of TSC Common Stock brought .5 share of National Series B Preferred Stock and 1½ National Warrants (A. 268). National's Series B Preferred Stock is entitled to a cumulative quarterly dividend at the annual rate of $1.25 a share and is convertible into .75 share of National Common Stock. National's Warrant entitles the holder to purchase one share of National Common Stock at $21.40 per share until October 31, 1978 (A. 268).

No exchange of National Common Stock was involved in the transaction. Depending upon a TSC stockholder's basis, either a capital gain or loss would be recognized by the stockholder

for federal income tax purposes. National recognized a capital loss (A. 270).

Issues Made by the Pleadings:

Framed as multifarious Proxy Statement deficiencies, Northway alleged a plan by National to buy from TSC all of its assets, business and properties "at a fraudulently low and grossly inadequate consideration and on terms that were otherwise grossly unfair to TSC and the independent stockholders of TSC." National and TSC denied this (A. 20-23, 60). National and TSC responses to Northway's allegations resulted in the following major issues on the pleadings.

Control Issue.

As to Northway's allegations of National control over TSC and concerning the relationship between the two companies, National and TSC denied that actual or working control of TSC had been transferred, or was even transferable, to National at the time National acquired the minority interest in TSC (A. 13-14); that National exercised any power to direct or cause the direction of TSC or that National exercised actual or working control of TSC (A. 18-19); that Stanley R. Yarmuth, President and chief executive officer of National, functioned or acted as TSC's chief executive officer or as an operating officer of TSC at any time (A. 19); and that the proposed transaction was dictated by National without any arm's length bargaining or negotiation between National and TSC (A. 26-27; see also Joint Answer ¶ 14, A. 27-60).

Market Rigging Issue.

As to alleged market rigging of National Common Stock and other alleged manipulations of relative securities values, National and TSC denied that National had been "engaged with" Madison Fund, Inc. in a "series of coordinated purchases" of

National Common Stock (A. 15); that National caused TSC to reduce its apparent income from operations or that the reduction in TSC's reported earnings resulted in a decline in the market prices quoted for TSC's securities which was out of line with the trend in market prices for comparable equity securities during the relevant period (A. 20).

Fairness Issue.

As to the alleged unfairness of the securities exchange ratio, National and TSC denied that the Proxy Statement failed to disclose any material facts concerning the favorable Hornblower & Weeks-Hemphill, Noyes ("Hornblower") opinion bearing on the fairness of the proposed transaction to the TSC stockholders (A. 52) and denied the alleged conflict of interest position of Mr. Blancke Noyes and his firm (A. 51-52).

Northway's Motion for Partial Summary Judgment:

On July 31, 1972, Northway filed its motion for partial summary judgment as to the liability of National and TSC (A. 91). After 2½ years of discovery,[1] Northway confined its motion to a few of its claims under § 14 of the 1934 Act. Its motion charged (i) inadequate disclosure of a change in control of TSC, (ii) non-disclosure of National's relationships to and alleged control of TSC, and (iii) that the Proxy Statement had falsely stated that the TSC Board had approved the proposed transaction. Northway also charged that the Proxy Statement's emphasis on market quotations was misleading because of (iv) non-disclosure of allegedly "coordinated purchases" of National's Common Stock by National and Madison Fund, Inc. and (v) undue emphasis on Hornblower's opinion concerning a "substantial premium over current market values" for the TSC shareholders coupled with non-disclosure of a Hornblower

1. Northway's discovery included 22 depositions upon oral examination exceeding 5,800 pages of transcript, written interrogatories, requests to admit and the production by National and TSC of tens of thousands of corporate documents.

opinion to National on intrinsic value of National Warrants. Northway did not press its Rule 10b-5 claims in its summary judgment motion.

National and TSC did not file a cross-motion for summary judgment. Their opposition to the motion was, in part, grounded on the various discovery papers before the court. In addition, National and TSC filed uncontradicted Opposing Affidavits by Bernard H. Barnett, Charles Evans Gerber, Richard H. Schaefer, Allan B. Solomon, Stanley R. Yarmuth and Bruce Zalman (A. 93-108).

The District Court Proceedings:

In the face of conflicting deposition testimony and the uncontradicted Opposing Affidavits, District Judge McLaren denied Northway's Motion for Partial Summary Judgment in all respects, either because Northway had failed to establish the absence of a genuine issue of material fact or because Northway was not entitled, as a matter of law, to judgment in its favor. 361 F. Supp. at 108. The essentials of the record and Judge McLaren's holdings on issues may be briefly summarized as follows.

Alleged Control of TSC.

The Opposing Affidavits and depositions of Richard H. Schaefer and Stanley R. Yarmuth raised a genuine issue as to whether National was in fact in "control" of the daily management of TSC. In his Opposing Affidavit Mr. Schaefer stated that he was President and chief administrative officer of TSC and a member of the TSC Board. He said that at all times he possessed and exercised operational control of TSC and that he was directly responsible, and exclusively accountable, to the TSC Board for the orientation and implementation of all corporate policies. Mr. Schaefer further said that all other officers and employees of TSC reported to him exclusively and he, in turn,

reported exclusively to the TSC Board. In short, it was Mr. Schaefer who led negotiation of the transaction for TSC (A. 102).

And in his deposition taken by Northway on December 23, 1969 Mr. Schaefer testified that, while under the TSC by-laws the Chairman of the Board was the chief executive officer, he really functioned as the chief executive officer (A. 180, 195-96).

In his Opposing Affidavit Mr. Yarmuth said that although he had become Chairman of the Board of Directors of TSC in March, 1969 he had "never acted as its chief executive or chief administrative officer" (A. 105). In his deposition taken by Northway on September 10, 1971 Mr. Yarmuth testified that in his conversations with Mr. Schaefer in early 1969 concerning the management of TSC he was concerned "with Mr. Schaefer staying with the company and continuing his management"; that it was hoped that Mr. Schaefer "would remain as chief executive officer"; and that Mr. Schaefer's "office would be chief executive officer" (A. 251).

Referring to the foregoing Judge McLaren said (361 F. Supp. at 111):

> "The affidavit and deposition testimony show that Shaefer [sic] managed TSC without consulting with or answering to National. This creates an inference, to which defendants are entitled in opposing a motion for summary judgment, that National was not in control of TSC.
>
> * * * * *
>
> Thus, viewing the evidence and the inferences therefrom in the light most favorable to defendants, the Court holds that plaintiff has failed to establish the absence of a genuine question of fact as to the material issue of whether National was in control of TSC."

National's Relationship to TSC.

Northway claimed that the Proxy Statement failed to adequately disclose the relationship between National and TSC. The essential points on this issue were lack of a recital that

Yarmuth was Chairman of TSC's Board and Simonelli was Chairman of its Executive Committee and absence of a reference to prior reports to SEC which stated National may be deemed a parent of TSC. On this issue Judge McLaren saw the "pivotal question" on the summary judgment motion to be whether the facts "relating to the relationship between TSC and National which were omitted from the joint proxy statement were, as a matter of law, material." 361 F. Supp. at 112. Judge McLaren could not conclude that these (as well as other claimed omissions) were material as a matter of law. Judge McLaren stated (361 F. Supp. at 114):

> "In passing on plaintiff's motion for partial summary judgment, the Court has considered the omitted facts in light of the manner in which other facts were disclosed which could have alerted the TSC shareholders to the possible bias of the management and board of TSC. . . . While the Court believes that the prior claims of control made to the SEC and Yarmuth's and Simonelli's other positions might have been considered important by TSC shareholders, it cannot conclude that these facts were so obviously important to them that reasonable minds could not differ on the issue; that is, as to whether they would have a significant propensity to affect the voting process."

Alleged Market Rigging.

As to Northway's several assertions that National "engaged with" Madison Fund, Inc. in a "series of coordinated purchases" of National Common Stock (A. 14, 38), there was no evidence in the summary judgment record before Judge McLaren that either National or Madison Fund, Inc. had any foreknowledge at any time of a proposed market purchase of National Common Stock by the other, or that either had any schedule, plan or program for the purchase (or not to purchase) from time to time of National Common Stock.

Mr. Yarmuth stated in his Opposing Affidavit that at no time did he have any advance knowledge of any market transaction

in National Common Stock by Madison Fund, Inc. He said that his sole knowledge of any transaction by Madison Fund, Inc. in National's Common Stock was after the fact and was derived from his observation of stock transfer reports shown to him from time to time by Mr. Solomon, Vice President of National. Mr. Yarmuth said that he had no knowledge of any plan, program, schedule or formula of Madison Fund, Inc. for the purchase of National Common Stock (A. 105; see also 256-57).

To like effect are the Opposing Affidavit of Allan B. Solomon and his deposition testimony that he became aware of Madison Fund, Inc. purchases of National Common Stock through his receipt and review of transfer sheets from time to time (A. 103; 225-26) and the Opposing Affidavit of Bernard H. Barnett, Chairman of the National Board and a director of Madison Fund, Inc., who stated that all of his knowledge of National Common Stock purchases by either Madison Fund, Inc. or National was gained after the fact (A. 93).

As to Northway's varied assertions as to market rigging, security values and comparative values of National and TSC securities (A. 14-15, 20-22, 34, 37, 44) there simply was no evidence in the summary judgment papers before Judge McLaren that National, or anybody else at any relevant time, was engaged in any effort in the market to buy any National securities which would be involved in the securities swap—*i.e.*, National Series B Preferred Stock and National Warrants.

Nor was there any evidence before Judge McLaren that National purchased any of its Common Stock in the market after September 17, 1969, until almost two weeks after the shareholders' meetings which voted approval of the proposed transaction. Mr. Yarmuth stated in his Opposing Affidavit that early in 1969 he made the decision that National would purchase some of its own stock in the open market and he personally directed the placement of each order to purchase until September 17, 1969 and that each such decision was made by him (A. 106). In their Joint Answer National and TSC affirma-

tively alleged that the only open market purchases of its own Common Stock made by National during the entire year 1969 were the limited number of transactions during the period March 25, 1969, through September 17, 1969 and two transactions on December 18 and December 23, 1969 all of which are shown, together with daily and monthly trading volume figures on Exhibit A attached to the Joint Answer (A. 54, 90). See also Opposing Affidavit of Bruce Zalman and related charts (A. 107, Chart facing 108).

Before Judge McLaren, Northway argued that the value of the National Series B Preferred Stock and the National Warrants was "directly and immediately dependent upon the value of the National Common." But the deposition testimony of Northway's own expert, Professor Erwin E. Nemmers, showed that he treated the National Warrants as "highly speculative" and that he indulged in at least three different identifiable exercises trying to value the Warrants (A. 15, 538). In his deposition testimony Mr. Noyes refused to regard the value of the Warrants as "dependent" on the price of the Common Stock (A. 140). And as to the National Series B Preferred Stock, the deposition testimonies of Professor Nemmers, Mr. Noyes and Mr. William E. Stiegelmeier established that the determinative factors bearing on value were the stock's dividend, yield and/or coverage (A. 136, 160-63, 199-201).

Again, recognizing the requirements of Rule 56 of the Federal Rules of Civil Procedure, Judge McLaren stated (361 F. Supp. at 116):

> "Although plaintiff's evidence shows the opportunity for coordination, and the inference that might be drawn from its evidence might support a finding of coordination, the Court is not free to draw such inferences. Thus, defendants' evidence succeeds in raising a genuine issue of fact as to whether the Madison purchases were coodinated [sic] with National's."

Hornblower's Opinion.

Northway also attacked the sufficiency of the Proxy Statement for its failure to disclose that Hornblower considered that the National Warrants had a value of approximately $3.50 each as compared with the November 7, 1969 closing price on the American Stock Exchange of $5.25 each as reported in the Proxy Statement (A. 519; 271). In substance, Northway asserted that the October 31, 1969 letter was at variance with the Proxy Statement's reference to "the substantial premium over current market values represented by the securities being offered to TSC stockholders" as being one of the factors considered by Hornblower in rendering a favorable opinion as to the fairness to the stockholders of TSC of the terms for the exchange of the shares of TSC for securities of National (A. 267; 35, 52).

The evidence before Judge McLaren on the summary judgment motion also included the minutes of the TSC directors' meeting of October 16, 1969 and the Hornblower opinion letter of the same date to the TSC Board which was attached as Exhibit A to the minutes (A. 427). The relevant paragraph of the October 16, 1969 opinion letter to TSC reads:

> "To arrive at our opinion we considered, among other things, the current market prices of the securities of both companies, the high redemption price of National Industries' Series B Convertible Preferred, the dividend and debt service requirements of both companies, the substantial premium over current market values represented by the securities being offered to TSC shareholders, and the increased dividend income."

The relevant portion of the TSC October 16, 1969 minutes states (A. 413):

> "The directors then discussed the appraisal report of October 16, 1969 from Hornblower & Weeks-Hemphill, Noyes. Mr. Yarmuth stated that under the original proposal from National, the stockholders of the corporation

would have received fewer shares and warrants than now proposed. Mr. Noyes then explained the analysis supporting the appraisal and stated that the present offer represents more than 40% premium to the corporation's stockholders based on current market values. Mr. Noyes stated that Hornblower & Weeks-Hemphill, Noyes suggested the present terms as being a fair offer and that National accepted such proposal without any negotiation. Mr. Noyes stated that his firm appraised the National $1.25 Series B Preferred as a sound value and that even though there may be some decline in the price of the warrants, the exchange offer is a fair one."

Confronted with the foregoing Judge McLaren concluded (361 F. Supp. at 116):

"Plaintiff bases its criticism of the failure to disclose that Hornblower relied upon a warrant value of $3.50 on its assertion that the use of this figure results in a very small premium, rather than the substantial one claimed. There is no evidence in the record of which the Court is aware to support this assertion. The truth of this assertion and the adequacy of the disclosure of the condition remain to be determined by the finder of fact and summary judgment on these grounds is thus precluded."

The Seventh Circuit Proceedings:

The Court of Appeals for the Seventh Circuit, entertaining an interlocutory appeal from the summary judgment denial pursuant to 28 U. S. C. Section 1292(b), reversed on the issues of liability and remanded the action for further proceedings. 512 F. 2d 324. The Seventh Circuit held that the Proxy Statement violated SEC Rule 14a-9 and expressly rejected this Court's approach in *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970) that omissions in a proxy statement are material only if they have a "significant propensity" to affect the shareholder voting process. In the Seventh Circuit's view materiality of any facts could be determined without regard to their propensity to affect the voting process. The critical test of materiality is

"relevancy alone," even if possibly "relevant for some, but not for others." 512 F. 2d at 331 & n. 13.

Acknowledging that its test of materiality would require many facts to be stated in a proxy statement which might not come within the scope of this Court's "stricter 'significant propensity' test" applied by Judge McLaren, 512 F. 2d at 330 & n. 11, and while agreeing with Judge McLaren that "control" by National of TSC had not been demonstrated in the summary judgment papers, the Seventh Circuit held that four omissions complained of by Northway and not found by Judge McLaren to have been material as a matter of law, were so important that "reasonable minds could not differ on the question of materiality." 512 F. 2d at 329.

SUMMARY OF ARGUMENT.

1. Full and fair disclosure requires only good faith and fair presentation of that which is important to the reasonable shareholder and investor. Materiality limits required disclosures to those important matters which have a real likelihood of influencing their decisions. Only when omitted information is so important that its non-disclosure renders a proxy statement false and misleading is its omission violative of Rule 14a-9 of the proxy rules. The Seventh Circuit's novel test of materiality would distort the disclosure standards and impose serious liabilities for omission of relevant details having little or no significance in corporate democracy.

2. The District Court correctly recognized that there were real disputes on important fact issues and serious gaps in the record which precluded granting summary judgment. The Seventh Circuit brushed aside those serious factual conflicts and improperly drew questionable inferences in violation of Rule 56 of the Federal Rules of Civil Procedure.

This Court should reverse and remand this action to the District Court for trial by jury.

ARGUMENT.

I.

The Standard of Materiality Limits Required Disclosures to Such Information as Is Important to the Reasonable Shareholder or Investor and Has a Significant Propensity to Affect His Judgments.

This case marks the first time this Court is presented squarely with the issue of what is the proper standard for materiality under the federal securities laws. *Mills* actually involved questions with respect to causation and its role in establishing a violation of Section 14(a) of the 1934 Act. Materiality of the calculated concealments which rendered the *Mills* proxy statement violative of basic shareholder rights had been found in the District Court, affirmed in the Court of Appeals and was unquestioned when the case was considered by this Court.

In *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128 (1972) this Court considered whether it should be necessary for the defrauded Indians to prove that they would not have sold their valuable rights had they known that the bank officials were cheating them by paying less than the real market price and, in addition, were dual agents who represented the purchaser while purporting to act for the Indians as sellers. There was no question as to the materiality of the failure of the bank officials to reveal a higher current price and their dual agency—everyone saw that as gross and palpable fraud.

Other courts (including the Seventh Circuit) have looked to *Mills* and *Affiliated Ute* for guidance in determining the materiality of omissions or misstatements under the securities laws, but in both those cases justice required that actual proof of causation be excused once the materiality of the misstatement or omission is plainly and clearly shown. Neither case supports the strange inference drawn by the Seventh Circuit that because probability is not an element of causation, it is, *a fortiori*, not

an element of materiality. Quite the contrary, this Court's emphasis on "significant propensity" in *Mills* and its recognition of the palpable fraud practiced on the Ute Indians indicates strongly that once the requirement of proof of causation is eliminated, the standard for establishing materiality becomes all the more important.

Full and fair disclosure under the securities laws requires only good faith and fair disclosure of that which is important—nothing more. Otherwise closed transactions would be subject to rescission or the award of substantial damages because of insignificant defects.

The Seventh Circuit adopted its new "might" test on the basis of its singular and narrowly focused reliance on this Court's statement in *Mills* that a determination of the materiality of misstatement or omission "embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote." This quoted language immediately precedes this Court's clarifying statement that "[t]his requirement that the defect have a significant *propensity* to affect the voting process is found in the express terms of Rule 14a-9. . . ." 396 U. S. at 384. The Seventh Circuit, in adopting its "might" test, repeatedly contrasted its approach with the contrary interpretation given to *Mills* by Judge Friendly in the Second Circuit's decision in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281, 1302 (2d Cir. 1973). 512 F. 2d at 330, 331 & n. 13.

Since this Court has not heretofore considered directly a standard or definition of materiality under securities laws, a brief review of legislative history and the role of SEC in rulemaking under the federal securities laws seems appropriate.

A.

Materiality Is the Key in Disclosure Standards.

The concept of materiality pervades all of the disclosure and fraud provisions of the federal securities laws. Similar concepts of materiality are applicable to misstatements or omissions in registration statements under the 1933 Act and to untrue statements or omissions of material facts under Rule 10b-5 which prohibits fraud in connection with the purchase or sale of securities.[2] Therefore any analysis of materiality cannot be limited to Rule 14a-9 but must extend to the comparable provisions of the 1933 Act from which Rule 14a-9 was derived and to Rule 10b-5 which, though subsequently adopted, has been the subject of a great deal of litigation and comment.

The Securities Act of 1933[3] ("Securities Act") and the 1934 Act[4] mandate full and fair disclosure of material information as a guiding principle. Disclosure is limited to such matters as are either necessary to discharge the SEC's obligations under the Acts or necessary or appropriate in the public interest or for the protection of investors.[5]

The Securities Act was enacted in response to the flotation during the post-World War I decade of $25 billion of securities which proved worthless.[6] The significance of the enumerated disclosure items in Schedule A to that Act (detailing required

2. Rule 10b-5 was issued under § 10(b) of the 1934 Act. See p. 26 n. 18.

3. 15 U. S. C. § 77a *et seq*. The sections of the Act are identified by the letters a-bb rather than by the corresponding Arabic numbers.

4. 15 U. S. C. § 78a *et seq*. The sections of the 1934 Act are identified by the letters a-jj rather than by the corresponding Arabic numbers. Recent amendments to the 1934 Act, adopted this year in P. L. [illegible]-29, have not as yet been included in this codification.

5. A significant portion of the text on pages 18-24 is taken directly from Release 34-11733; File No. S7-593, Environmental and Social Disclosure, 40 Fed. Reg. 51656 *et seq*., Nov. 6, 1975.

6. H. R. Rep. No. 85, 73d Cong., 1st Sess. at 2 (1933).

content of registration statements) is essentially economic in nature. As the House Report which preceded the Securities Act states:

> "The type of information required to be disclosed is of a character comparable to that demanded by competent bankers from their borrowers, and has been worked out in light of these and other requirements."[7]

Liability for material false or misleading statements flows from violations of Sections 11, 12(2) and 17 of the Securities Act and Sections 10, 14 and 18 of the 1934 Act.

Section 14(a) of the 1934 Act provides that proxies may be solicited only in conformity with "such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." The Congressional purpose in enacting Section 14 has been characterized as "to require fair opportunity for the operation of corporate suffrage."[8]

The Congressional intent in creating liabilities based on the omission of information which makes the registration statement misleading is further clarified by the derivation of this concept. Professor Loss has observed: "[T]he Securities Act of 1933 did not spring full grown from the brow of any New Deal Zeus"

7. *Id*. at 4. In a recent speech, Ray Garrett, Jr., former Chairman of the SEC, ably summarized the Congressional purpose in adopting the disclosure requirements in Schedule A when he said:

> "In adopting Schedule A, Congress obviously posited as the typical prospective investor, a reasonable economic man whose needs and desires for information were basic, financial stuff: balance sheets and earnings statements, capital structure, rights of security holders, especially of the securities being offered, a description of the business, major customers and contracts, litigation that might be costly, etc." Ray Garrett, Jr., Uses of Disclosure, National Investor Relations Institute, September 30, 1975.

8. S. Rep. No. 792, 73d Cong., 2d Sess. at 12 (1934). H. R. Rep. No. 1383, 73d Cong., 2d Sess. at 13-14 (1934); see also *Securities and Exchange Commission* v. *Transamerica Corp*., 163 F. 2d 511, 518 (3d Cir. 1947), *cert. denied*, 332 U. S. 847 (1948), and *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 431-32 (1964).

—neither did the concept of materiality which is at the heart of the disclosure requirements of the 1933 Act. The legislative history relied strongly on English decisions relating to materiality, particularly material omissions under the English Companies Act, which long before the 1933 Act prohibited and made actionable material misrepresentations in prospectuses.[9]

B.

SEC Uses Materiality as Limitation on Required Disclosures.

In administering the various federal securities laws,[10] the SEC was expected to become entirely familiar with the securities markets and to develop an expertise which would enable it to resolve questions such as what disclosure of information regarding securities and issuers is necessary to discharge the SEC's responsibilities under the Securities Act and the 1934 Act[11] or is "necessary or appropriate in the public interest or for the protection of investors."[12] SEC has discretion to require specific

9. I Loss, *Securities Regulation* (2d Ed., 1961) pp. 3, 4-7.

10. The SEC's organic statutes include:

Securities Act of 1933, 15 U. S. C. § 77a *et seq.*

Securities Exchange Act of 1934, 15 U. S. C. § 78a *et seq.*

Public Utility Holding Company Act of 1935, 15 U. S. C. § 79 *et seq.*

Trust Indenture Act of 1939, 15 U. S. C. § 77aaa *et seq.*

Investment Company Act of 1940, 15 U. S. C. § 80a-1 *et seq.*

Investment Advisors Act of 1940, 15 U. S. C. § 80b-1 *et seq.*

11. SEC's general rulemaking authority is found in Section 19(a) of the Securities Act and Section 23(a)(1) of the 1934 Act, which authorize SEC to promulgate such rules "as may be necessary to carry out the provisions of this title," and "as may be necessary or appropriate to implement the provisions of this title for which [it is] responsible or for the execution of the functions vested in [it] by this title . . .," respectively.

12. The courts have repeatedly recognized broad discretion in the SEC to make determinations whether to take action and the form any action should take, dependent on its expertise in securites matters. See *e.g., Securities and Exchange Commission* v. *Chenery Corp.*, 332 U. S. 194, 209 (1947).

kinds of information to be disclosed in proxy statements even though each and every one of such items of information might not be material.

Whether particular disclosure requirements are necessary involves a balancing of competing factors.

> "As a practical matter, it is impossible to provide every item of information that might be of interest to some investor in making investment and voting decisions.
>
> * * * * *
>
> The weighing of these factors, among others, is the mechanism by which disclosure is rendered fair as well as full. . . ."[13]

The SEC has generally resolved these various competing considerations by requiring disclosure only of such information as the SEC believes is important to the reasonable investor—"material information."[14] 17 C. F. R. §§ 230.405(1), 230.408, 240.12b-2(j), and 240.14a-9(a). Using materiality as a limita-

13. SEC Release, 34-11733; File No. S7-593 Environmental and Social Disclosure, 40 Fed. Reg. 51656, at 51659-60, Nov. 6, 1975. Participants in a 1975 SEC proceeding on Environmental and Social Disclosure (File No. S7-593) suggested more than 100 topics concerning which they desired disclosure. A disclosure document which incorporated each of these suggestions would consist of excessive and possibly confusing detail, whether provided directly to investors or filed with the SEC for inspection by interested persons.

14. Rule 405(1) under the Securities Act provides:

> "The term 'material', when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered."

Rule 408 provides:

> "In addition to the information expressly required to be included in a registration statement, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading."

Rule 12b-2(j) under the 1934 Act is worded substantially the same as Rule 408 above.

tion is necessary in order to insure meaningful and useful disclosure documents of benefit to investors generally without unreasonable costs to registrants and their shareholders.

The proxy rules specify in considerable detail which information is required to be disclosed. In Schedule 14A, which consists of 22 separate items, SEC has prescribed the information which must be provided to shareholders in connection with solicitation of their proxies with respect to the various specified matters. Item 14 of Schedule 14A specifies the information which must be included in a proxy statement if action is to be taken with respect to "mergers, consolidations, acquisitions, and similar matters." Item 15 details the financial statements which must be incorporated in a proxy statement seeking approval for a merger, acquisition or certain other matters. Neither of the courts below held that the Proxy Statement issued jointly by National and TSC failed to include any of the detailed information required by Schedule 14A.

Rule 14a-9 fits into this scheme in that it prohibits false and misleading statements and prohibits the omission of statements required in order to avoid making false and misleading the specified items which Schedule 14A requires to be included in the proxy statement. It provides:

> "No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

Accordingly, the question whether an omission is "material" must be analyzed in terms of whether it so seriously distorts the information contained in the proxy statement that the proxy

statement becomes false and misleading. For a defect in disclosure to be "material" in relation to this regulatory purpose, it must be shown that the "free exercise of the voting rights of stockholders" had been "frustrated" because the stockholders lacked an explanation as to the "real nature of the questions" on which they were asked to vote. *J. I. Case Co.* v. *Borak, supra,* 377 U. S. at 431.

Thus, under SEC's proxy rules the focal point in preparing every proxy statement is the materiality[15] of the information, not merely its relevancy. Rule 14a-9 is violated only where both the omitted fact is important and where its omission makes a proxy statement false and misleading.

A proper standard of materiality in this context must take into account not only the protection of investors but the necessity of having a realistic and attainable standard for preparation of such documents.

Compliance with the doctrine of "equal emphasis", whereby certain disclosures which bear upon other disclosures must be given similar attention within the confines of a proxy statement, would present an impossible challenge if the views of the court below prevail and it becomes necessary to present reams of cumulative, near-trivial, detailed data in an effort to accomplish disclosure of all relevant material. Proxy statements which now run 80 to 100 pages would run several hundred pages. Even the most tolerant, reasonable and prudent shareholder would not then read them.

The SEC has repeatedly urged adherence to the fundamental concept that disclosure statements must be clear, concise and

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15. SEC uses the term "materiality" to convey essentially the same concept as in modern tort or contract law—a matter to which a reasonable man would attach importance in determining his choice of action in the transaction in question. *Restatement of Torts,* § 538; III Loss, *Securities Regulation* (2d Ed. 1961) p. 1431; also SEC's first decision on this issue: *In the Matter of Charles A. Howard,* 1 S. E. C. 6 (1934).

readable.[16] Admittedly, complicated transactions between large business concerns will require significant space to properly explain to investors. However, the very purpose of providing fair corporate suffrage with respect to every publicly-held equity security will be thwarted if proxy statements must be encyclopedias prepared by attorneys and accountants solely with an eye to protecting against other attorneys seeking to find factual omissions which are of no practical significance except that they may be considered relevant and a stepping stone to private litigation.

C.

Materiality Means Importance and a Strong Likelihood of Impact on the Reasonable Shareholder.

Mr. Justice Harlan struck an appropriate balance when he emphasized in *Mills* that omitted material to be "material" must be such as to have a *significant propensity* to affect the voting process.[17] 396 U. S. at 384-85. Similarly, Judge Friendly in

16. Securities and Exchange Commission Guides for Preparation and Filing of Registration Statements, Guide No. 5, Securities Act Release No. 4936, as amended, states:

> "In order to make prospectuses more readable and understandable, and therefore more useful, registrants should limit their length and complexity by careful organization of the material, . . . and the avoidance of . . . *unnecessary detail.*" [Emphasis added.]

Schedule 14A, Item 14, which sets forth the applicable requirements for disclosure of the transaction between National and TSC emphasizes:

> "(a) Outline briefly the material features of the plan. . . .
>
> (b) . . . What is required is information essential to an investor's appraisal of the action proposed to be taken."

17. The Court of Appeals below was "convinced that the test we adopt is supported by the reasoning of the Supreme Court in *Mills* and in Affiliated Ute [because it] would make little sense to hold that causation is established by a more lenient standard then materiality." 512 F. 2d at 331. However, that is exactly what this Court took great pains to point out in *Mills* and *Affiliated Ute*—that it makes a great deal of sense, from a policy standpoint, not to require difficult causation proofs once materiality is established. Neither

Gerstle v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281, 1302 (2d Cir. 1973) rejected a concept of materiality which is simply suggestive of a mere possibility, however unlikely. In addition, Judge Wisdom in *Smallwood* v. *Pearl Brewing Co.*, 489 F. 2d 579, 604 (5th Cir. 1974), *cert. denied*, 419 U. S. 873 (1974), emphasized that he found no evidence in *Mills* of any desire by this Court to relax the standard of materiality to a mere possibility of influence upon a reasonable investor.

Thoughtfully, the Second Circuit in *Gerstle* and the Fifth Circuit in *Smallwood* defined materiality in terms of what *would* be important to shareholders in deciding how to vote, not simply what *might* be important to them. Another articulation of this same realistic concept of materiality was set forth in *General Time Corporation* v. *Talley Industries, Inc.*, 403 F. 2d 159, 162 (2d Cir. 1968), *cert. denied*, 393 U. S. 1026 (1969), namely:

> "The test, we suppose, is whether, taking a properly realistic view, there is a substantial likelihood that the misstatement or omission may have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course."

In essence, a standard tending toward probability rather than the mere possibility of effect upon a shareholder's decision is what this Court should confirm as the appropriate standard.

Mills nor *Affiliated Ute* meant to eliminate the need in determining materiality that there be real probability an omitted fact would affect a voting (or investment) decision. *Mills* and *Affiliated Ute* say that once enough probability to establish materiality is shown, in appropriate circumstances it is not necessary to go further and prove causation. That in no way supports the Seventh Circuit's proposition that because probability is not an element of causation, it is, *a fortiori*, not a materiality element. On the contrary, this Court's emphasis on "significant propensity" appears to be predicated upon the fact that once the requirement for proof of causation is eliminated, the standard for materiality becomes all the more important. This is vital to avoid rescission of transactions or the imposition of damages on the basis of defects too insignificant to have an impact on the voting process.

Other Courts of Appeals have adopted the "would" test rather than the Seventh Circuit's "might" test in the related area of liability under Section 10(b) of the 1934 Act and Rule 10b-5.[18] The "would" test has also been adopted in determining liability for defective tender offers under Section 14(e) of the 1934 Act.[19] It has also been adopted under Section 12(2) of the Securities Act. *Johns Hopkins University* v. *Hutton*, 422 F. 2d 1124 (4th Cir. 1970).

The test of materiality used by other Courts of Appeals is consistent with SEC's definition of the term "material" which limits information required to be disclosed to matters of importance to the average reasonable shareholder.[20]

In 1934 Congress saw a way to avoid many of egregious injustices then being done to the average capital investor and declared that such corporate "secrets" as then made those injustices possible must be disclosed fairly. This same concern with public disclosure of important corporate developments which induce investors to act is the dominant theme in three major post-1934 materiality cases, *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968), *cert. denied sub nom., Coates* v. *S. E. C.*, 394 U. S. 976 (1969); *In re Cady, Roberts & Co.*, 40 S. E. C. 907 (1961);

18. *Titan Group, Inc.* v. *Faggen*, 513 F. 2d 234 (2d Cir. 1975); *Robinson* v. *Cupples Container Co.*, 513 F. 2d 1274 (9th Cir. 1975); *Marx* v. *Computer Sciences Corp.*, 507 F. 2d 485 (9th Cir. 1974); *Gordon* v. *Burr*, 506 F. 2d 1080 (2d Cir. 1974); *Harnett* v. *Ryan Homes, Inc.*, 496 F. 2d 832 (3d Cir. 1974); *Vohs* v. *Dickson*, 495 F. 2d 607 (5th Cir. 1974); *Rochez Bros., Inc.* v. *Rhoades*, 491 F. 2d 402 (3d Cir. 1974); *Arber* v. *Essex Wire Corp.*, 490 F. 2d 414 (6th Cir. 1974), *cert denied*, 419 U. S. 830 (1974); *John R. Lewis Inc.* v. *Newman*, 446 F. 2d 800 (5th Cir. 1971); *Herpich* v. *Wallace*, 430 F. 2d 792 (5th Cir. 1970).

19. *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F. 2d 341 (2d Cir. 1973), *cert. denied*, 414 U. S. 910 (1973); *Gulf & Western Industries, Inc.* v. *Great A. & P. Tea Company, Inc.*, 476 F. 2d 687 (2d Cir. 1973); *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F. 2d 937 (2d Cir. 1969).

20. SEC Rules 405(1), 408, 12b-2(j); respectively, 17 C. F. R. §§ 230.405(1), 230.408, 240.12b-2(j).

and *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 1934 Act Release No. 8459 [1967-1969 Transfer Binder], CCH Fed. Sec. L. Rep. ¶ 77,629 (November 25, 1968).[21]

Materiality must be so defined that it limits required disclosures to those facts which are important to the reasonable shareholder and investor. The relative importance of any particular information can be determined by its likelihood to affect the shareholder/investor's decisions. Only when required disclosures are so restricted is the mandated disclosure fair as well as full.

II.

Within This Summary Judgment Record and Under a Proper Test of Materiality, None of the Complained of Omissions Is Material as a Matter of Law.

This matter comes before the Court on a summary judgment record; therefore, to prevail Northway must show there are no genuine issues of material fact and the omissions were so important that the Proxy Statement was thereby rendered false and misleading in violation of Rule 14a-9.

Ordinarily, materiality of an omission is a question of fact, to be determined by the trier of fact. Only when reasonable men may not differ on the issue of materiality can it be determined as a matter of law. *Johns Hopkins University* v. *Hutton*, 422 F. 2d 1124, 1129 (4th Cir. 1970); *Rogen* v. *Ilikon Corp.*, 361 F. 2d 260, 266 (1st Cir. 1966). Moreover, if different permissible inferences may be drawn from the underlying facts or if

21. In *Texas Gulf Sulphur*, insiders artfully delayed disclosure of one of the greatest mineral finds of all time. In *Cady, Roberts*, an insider and his associates liquidated stock positions before the trading market learned that a big industrial corporation had passed its dividend. It is not surprising that in *Merrill Lynch*, SEC found the securities firm seriously at fault where a few preferred customers gained the benefit of liquidating positions and short sales in Douglas Aircraft's stock as Merrill Lynch's preferred customers while the general public remained unaware of a disastrous drop in Douglas Aircraft's earnings.

there are gaps in the summary judgment record, no summary judgment may be granted. *Adickes* v. *S. H. Kress & Co.*, 398 U. S. 144 (1970); *United States* v. *Diebold, Inc.*, 369 U. S. 654, 655 (1962). Accordingly, whenever different inferences reasonably may be drawn from the underlying facts, those most favorable to TSC and National must be assumed.

Northway asserted that the Proxy Statement was deficient in many respects because it failed to state facts claimed to be material as a matter of law. Many of the asserted defects have been abandoned by Northway or rejected below and are not presently before this Court. The remaining four omitted factual matters were found by the court below to be material as a matter of law. 512 F. 2d at 324.

The rationale of the Court of Appeals, as to each of the four omissions it found material as a matter of law, actually involved one or more of the following shortcomings: (i) a real dispute over genuine issues of material fact, (ii) a dearth of evidentiary facts, permitting one to draw equally plausible inferences that such omissions were not material, or (iii) the omission of cumulative, relatively unimportant information which was of little interest to most reasonable shareholders.

There is no evidence that TSC and National consciously withheld any material information from shareholders or that the Proxy Statement was prepared with a reckless disregard for important facts. To the contrary: it is clear that the Proxy Statement was drafted by reputable attorneys in a professional manner (A. 95).

The Proxy Statement was duly submitted to the SEC's Division of Corporate Finance in preliminary form. That Division of the SEC was familiar with the recent registration statements, periodic reports and proxy statements filed by National and TSC, including those in early 1969 in which the equity interest of National in TSC was first disclosed. The SEC's Corporate Finance Division replied in a 3-page comment letter

which took no exception whatever to any of the alleged defects about which Northway complained in the Court of Appeals (A. 96-100).

A.

Omission of a Statement That Stanley R. Yarmuth Was Chairman of the Board of TSC and That Charles F. Simonelli Was Chairman of the TSC Executive Committee Was Not Material.

Although the Court of Appeals agreed with District Judge McLaren's finding that whether National was in control of TSC was genuinely in dispute (512 F. 2d at 329), the court below was persuaded that the Proxy Statement became fatally defective under Rule 14a-9 for want of recitations that National's President, Stanley R. Yarmuth, had been elected Chairman of the Board of TSC and National's Executive Vice-President, Charles F. Simonelli, acted as Chairman of the TSC Executive Committee. The panel found these omissions were material as a matter of law "[b]ecause these facts[22] were persuasive indicators that the TSC board was in fact under the control of National, and that National thus 'sat on both sides of the table' in setting the terms of the exchange. . . ." 512 F. 2d at 333. Neither the materiality of these omissions nor the conclusion is supported by the summary judgment record or by logic.

There is no evidence that the terms of the transaction were set by the same persons sitting on both sides of the table. Neither Mr. Yarmuth nor any other National representative negotiated the terms of the transaction on behalf of TSC. On the contrary there is credible, uncontroverted deposition testimony that Mr. Noyes and TSC's aggressive President, Mr. Richard H. Schaefer, negotiated terms of the transaction effectively on behalf of TSC and its shareholders. The terms of the transaction grew out of a proposal made by National to Hornblower, which was acting as the investment banking representatives and advisors of the TSC Board of Directors. Blancke Noyes was a

22. Coupled with the omission discussed at pp. 32-34 hereof.

partner in the Hornblower firm and it was he who informed National that their original proposal was insufficient and suggested the actual terms of the transaction as being a fair offer. National accepted the Hornblower counter-proposal without any negotiation.[23] Moreover it was Schaefer who actually worked with Noyes in representing the interests of TSC in the negotiations with National (A. 101).

Nor could the court below properly ground its holding on this point upon potential influence which National might have exercised upon the decision of the TSC Board to approve and proceed with this transaction. Only directors not affiliated with National voted for the resolutions at the October 16, 1969 TSC Board meeting. 512 F. 2d at 328. The significant facts, admittedly disclosed in plain language in the Proxy Statement, sufficiently alerted every reasonable TSC shareholder to the fact that National had a substantial influence on the TSC Board when five of the ten TSC directors were plainly identified as National's nominees.

The Proxy Statement (A. 267-68) set forth prominently under separate headings at pages 6 and 7, first, the approval by the TSC Board of Directors of the sale to National and, immediately thereafter, a paragraph setting forth the fact that National owned approximately 34% of the outstanding voting stock of TSC. Then in the succeeding paragraph, five out of ten members of the TSC Board were described as National's nominees. It was expressly stated that Mr. Yarmuth was President and a director of National and that Mr. Simonelli was Executive Vice-President and a director of National. These disclosures were plainly spelled out in three successive paragraphs, on page 6 of the Proxy Statement, and the facts were flagged with headings in equally-sized bold face type as follows:

BOARDS OF DIRECTORS APPROVAL

* * *

23. A. 413.

NATIONAL'S EQUITY INTEREST IN TSC

* * *

NATIONAL'S NOMINEES ON TSC'S BOARD

Obviously every reasonable TSC shareholder, after reading these paragraphs and knowing of National's 34% voting power in TSC, was sufficiently informed that National had a position of influence on the TSC Board of Directors which approved the transaction and recommended it to TSC's shareholders. As a result, this same reasonable TSC shareholder had material facts sufficient for determining the weight to be given to the TSC Board's approval of the transaction. The additional revelation that Messrs. Yarmuth and Solomon were respectively the Chairman of the TSC Board and of its Executive Committee would have merely been cumulative.

Whatever may be said of the relevancy of such additional information with respect to Messrs. Yarmuth and Simonelli, it can hardly be said that as a matter of law this additional information would have had a significant propensity to affect the voting of TSC shareholders; the record on summary judgment does not permit drawing a conclusion as to the materiality of these admittedly omitted facts.

The Court of Appeals drew its inferences on the basis of the titles without reference to what in fact were the functions actually performed by the persons involved, including Schaefer who was TSC's active full-time executive. In fact, there was no specific provision in the TSC by-laws for an executive committee although there was provision for the Board to select and act through committees of its choosing from time to time. Not only was there a lack of a specific provision for an executive committee, but there was no indication that the person who acted as chairman of an executive committee thereby became an "officer" of the corporation (A. 442-43, 444-48).

Only by stretching its "relevancy" test wide enough to cover all the factual gaps in the summary judgment record could the

panel of the court below conclude that omission of a recitation of the titles of Messrs. Yarmuth and Simonelli in the section of the Proxy Statement discussing the TSC Board of Directors was material as a matter of law.

B.

Omission of Reference to Prior SEC Filings of National and TSC Which Stated National "May Be Deemed to Be a Parent" of TSC Was Not Material.

National's acquisition of the Schmidt TSC stock in February, 1969, required it to file a Form 13D with SEC because it had obtained in excess of 10% of the voting stock of TSC. In its Form 13D National answered Item 4 by stating it had acquired approximately 33% of the outstanding voting shares of TSC, and "accordingly, National *may be* deemed to be a 'parent' of TSC as that term is defined in the rules and regulations under the Securities Act of 1933." [Emphasis added.] (A. 473.) National made this statement based solely upon its stock ownership in TSC. In February, 1969 there was no other relationship whatever between the two corporations.[24]

Both the Court of Appeals and the District Court found the alleged control of TSC by National was an unreconciled material fact question on the summary judgment record which should be left to the trier of fact. Hence the court below lacked the factual data required to assess the importance of the prior SEC filings.

The Court of Appeals could not and did not hold that, if disclosed, the recital contained in earlier SEC filings (13D and 8-K) that "National may be deemed a parent of TSC", would

24. TSC's Form 8-K for the month of February, 1969 was required because Schmidt's control of TSC had ceased upon National's purchase of Schmidt's stock and the resignations of TSC founder Schmidt and his son from the TSC Board. Its Form 8-K incorporated a similar statement which was contained in Item 3(a) of the TSC annual report on Form 10-K for the year ended October 31, 1968; namely, the stock purchased, coupled with cessation of Schmidt's control of TSC as its founder, gave rise to a possibility that National "may be" deemed a parent of TSC. (A. 517.)

have revealed National's control. Instead the court below merely ascribed significance to such disclosure as bearing on National's position of influence in TSC. 512 F. 2d at 333. This had been done in the Proxy Statement by the plain, prominent and accurate disclosures of National's five nominees on the TSC Board and its 34% ownership of TSC's voting stock, the sole fact upon which the recital in the SEC filings was based.

The only way to gauge actual control is by putting it to the test in a dispute situation. Since National and the old TSC management led by Schaefer never drew any clear-cut battle lines, no one ever really knew who could ultimately control TSC during the entire period between the Schmidt purchase and consummation of the shareholder-approved purchase of TSC's assets. National would have taken a substantial risk if it presented information leading readers to conclude National *did* have control—for National shareholders also had to approve the transaction described in the joint Proxy Statement. If "some few" National shareholders then arguably voted for the transaction based on an incorrect inference that their management was in control of the negotiations, they could seek to impose liability on National for the subsequent marked decline in National Common Stock.

National had a choice of doing one of two things: (i) refrain from making any conclusory statements about control, or (ii) make the disclosures the Court of Appeals would require—along with a disclaimer of knowing who *actually* controlled TSC. Manifestly, it would have been misleading not to make such a disclaimer without actual knowledge. The Proxy Statement reflects the sensible choice actually made in November, 1969; the latter course (ii) would have risked confusing shareholders. Indeed, in October, 1969 when Hornblower told National that its exchange offer was insufficient and made a specific counter-proposal, National accepted Hornblower's counter-proposal without further discussion. At the very least this tended to show that National was not in control of TSC at that

point in time because it was TSC's representatives who fixed the terms of the transaction.

Finally, it is not surprising that the representatives of TSC and National did not see a need to state in the Proxy Statement that National might be deemed to be a parent of TSC as they had recited in their required filings in February and March of 1969. There was no requirement for any such recital in any of the various items in Schedule 14A of the proxy rules, but both corporations believed this type of recital was appropriate in a required filing (Form 8-K) when the control of TSC by Schmidt ceased and, as to National, when it acquired 33% of the voting stock (Form 13D) from founder Schmidt and members of his family. TSC and National had already made these disclosures at the time and in the way they were required to be made under the applicable rules of SEC. With the alleged control of TSC by National a hotly disputed question of material fact, the holding by the Court of Appeals that this omission was a material defect in the Proxy Statement as a matter of law lacks any rational basis.

C.

Omission of Reference to the Hornblower Opinion on Value of National's Warrants Was Not Material.

The Hornblower opinion to the TSC directors on the fairness of the transaction to TSC's stockholders was referred to directly at page 6 of the Proxy Statement where it was disclosed:

> "In such opinion, said firm considered, among other things, the current market prices of the securities of both corporations, the high redemption price of the National Series B Preferred Stock, the dividend and debt service requirements of both corporations, *the substantial premium over current market values represented by the securities being offered* to TSC stockholders and the increased dividend income." [Emphasis added.] (A. 267.)

The Hornblower investment banking firm had made a detailed examination of the merits of the TSC and National securities in September and October, 1969, well in advance of the November 12, 1969 Proxy Statement. Blancke Noyes, who was a partner in the Hornblower firm, continued as a TSC director after National's acquisition of the Schmidt stock in February, 1969. It was Mr. Noyes, his partners and the Hornblower employees who actually determined the exchange ratio which became the crux of the transaction between National and TSC (A. 413).

At TSC's request, Mr. Noyes' firm gave the TSC Board a favorable written opinion on the fairness of the transaction to TSC shareholders (A. 427). This written report by the Hornblower firm was discussed during the October 16, 1969 TSC directors' meeting and Mr. Noyes explained the analysis supporting his firm's appraisal, including the fact that the exchange ratio represented more than a 40% premium to the TSC stockholders based on *current market values.* Noyes also pointed out that it was his firm which had suggested the present exchange ratio as being a fair offer and that National had accepted their proposal without any negotiation.

After explaining that his firm appraised the National $1.25 Series B Preferred as a sound value, Noyes indicated that even though there might be some decline in the price of the Warrants, the exchange offer was a fair one. Following this and other explanations of the proposed transaction, the required resolutions were adopted by unanimous vote of four disinterested TSC directors who voted on the transaction.

Prior to the transaction only 487,000 of National's Warrants were listed on the American Stock Exchange. The transaction called for National to issue approximately 2.6 million additional Warrants in connection with the transaction following the shareholders' meetings on December 5, 1969. Accordingly, National needed an independent, outside opinion on the intrinsic value of the Warrants which it would issue to TSC

stockholders in the transaction. Late in October, 1969, Hornblower was requested by National to give National a written opinion on the value of the National Warrants which National could use in booking the transaction on its financial records. Hornblower gave National its written opinion, dated October 31, 1969, on the intrinsic value of the National Warrants as of October 9, 1969, taking into account not only all the conventional factors in valuing warrants but also the fact that approximately 2.6 million additional Warrants would be issued in connection with the acquisition (A. 519).

It was this subsequent Hornblower opinion to National which the court below erroneously said contained "bad news" about the National Warrants and which the court concluded should have been disclosed in the Proxy Statement because it was material as a matter of law. 512 F. 2d at 331, 335.

To reach this conclusion the Court of Appeals had to make several inferences which were not justifiable on the summary judgment record. The court below first inferred a prediction of future market values from the recital of the factors considered by the Hornblower firm on page 6 of the Proxy Statement: current market prices of the securities of both corporations, the high redemption price of the National Series B Preferred Stock, the dividend and debt service requirements of both corporations, the substantial premium over current market values represented by the securities being offered to TSC stockholders, and the increased dividend income.

The table of stock prices on page 10 of the Proxy Statement showed market prices of all pertinent securities of both corporations at January 1, 1967 and the final entry was market prices as of November 7, 1969, all as required by Schedule 14A. Although many other inferences were more readily discernible, the Court of Appeals concluded that there was a prediction of future market prices implicit in "linking the evaluation of the proposed exchange to current market values", 512 F. 2d at 334. Then, the court below proceeded to confuse

two very different things: (i) the October 16, 1969 written Hornblower opinion to the TSC Board on the fairness of the transaction which included comparative current market prices as a factor considered by Hornblower in reaching its conclusion on the fairness of the transaction, and (ii) the October 31, 1969 Hornblower letter to National on intrinsic value of the Warrants which was needed by National in order to put the transaction on National's books. In so doing the Court of Appeals, even though working with a summary judgment record, ignored the differences between market prices and intrinsic value and drew an inference favorable to Northway on its summary judgment motion as to liability of TSC and National.

Page 10 of the Proxy Statement reflected recent market prices of the TSC Common and Preferred Stock and National's Warrants and Series B Preferred which were to be exchanged for TSC assets in the transaction. Recent market prices on National's Common Stock were also scheduled. These were required disclosures under the proxy rules.[25]

The Proxy Statement properly referred to market prices and Hornblower spoke of current *market* prices of the securities of both companies as a factor considered in reaching its favorable opinion.[26]

Hornblower's later opinion to National shows plainly it focused on value, not market price, and certainly not market price at any future date. That Hornblower's evaluation was made "in light of the fact that approximately 2.6 million additional Warrants will be issued later in 1969 in connection with the acquisition," might only imply that Hornblower gave particular emphasis to one of several factors contributing to the Warrants' intrinsic value. The Seventh Circuit's misreading of the record on this point becomes apparent from the penultimate paragraph of the letter, namely:

25. Section 14(a) of the Act and Schedule 14A, Item 14(c), 17 C. F. R. § 240.14a-101, Item 14(c).

26. A. 427.

> "After studying the price relationships of other warrants traded publicly, referring to customary systems of warrant evaluation, and considering the particulars of the proposed acquisition, we concluded that the warrants in question had a value of approximately $3.50."

There was no prediction of a future market price but a determination of intrinsic value of the Warrants which National needed for accounting purposes in recording its acquisition of TSC's assets in a taxable transaction (A. 148-51, 154-56).

This later Hornblower letter did not contradict or take issue with the points made in its prior written opinion to the TSC directors nor did it conflict with the recitations in the Proxy Statement as to factors which Hornblower had taken into account in reaching its conclusion on the fairness of the transaction. The letter to National dealt only with "intrinsic value" of the National Warrants and did not speak to current market prices of the National Warrants or make any prediction of the future market prices of the same security.

It should have been impossible to conclude that the October 31, 1969 letter to National on the value of the Warrants conflicted with or contradicted the earlier opinion based on different premises, *i.e.*, comparative market values. Indeed disclosure of the subsequent Hornblower opinion on intrinsic value of the Warrants would have been mischievous, unless similar evaluations were made and disclosed with respect to all of the other securities of TSC[27] and National involved in the transaction. This surely would have brought down the wrath of SEC when most of the securities were actively traded on the New York and American Stock Exchanges, both of which gave objective daily evidence of market prices.

At most the later Hornblower opinion on the value of the Warrants created an ambiguity which should not and could not

27. In fact, the present state of the record permits (if not requires) the assumption that Petitioners could show at a trial that there were indications that market prices of TSC's securities could be expected to decline further. See, *e.g.*, *Adickes* v. *S. H. Kress & Co.*, 398 U. S. 144 (1970).

be resolved on a summary judgment record. These matters could only be determined by the jury after hearing all the evidence, which would include hearing the testimony of the author of these letters regarding his reconciliation of the claimed difference or conflict between them and judging his credibility, and also hearing the expert testimony by others on the issue. Only then, after the jury had had an opportunity to assess whether a serious conflict or ambiguity actually existed, could a determination of the materiality of this second Hornblower letter properly be made. Judge McLaren correctly so held and characterized this issue as unripe for decision on Northway's summary judgment motion. 361 F. Supp. at 116.

D.

Omission of Reference to Purchases of National's Common Stock by Madison Fund, Inc. and the Method of Disclosing National's Own Purchases of Its Common Stock Was Not Material.

The Court of Appeals found that on the summary judgment record there was a material non-disclosure and that Rule 14a-9 was violated because the Proxy Statement failed to recite purchases by Madison Fund, Inc. ("Madison") of National Common Stock during 1968-1969, and also failed to make more prominent disclosures of purchases of National Common Stock by National itself. 512 F. 2d at 335-36.

Northway, in support of its summary judgment motion, asserted and argued that Madison and National had conspired to purchase National Common Stock in "coordination" which, in turn, would be significant to a shareholder in assessing the recent market prices of National Common Stock which were shown in the Proxy Statement. Northway alleged this conspiracy could be inferred from the following facts: Edward Merkle who was the President of Madison was a consultant of National receiving $12,000 per year and Bernard H. Barnett, who was Chairman of National's Board of Directors, was also a director

of Madison. During the period January 1, 1969 to October 17, 1969, National purchased 48,300 shares of its Common Stock or 2.4% of reported market transactions in that period.[28] Madison's purchases of National Common Stock in the same period were 54,400 shares or approximately 2.5% of reported market transactions.

National sold none of such stock during the period and made no further purchases of its Common Stock between September 17, 1969 and late December, 1969, subsequent to the December 5, 1969 shareholders' meetings at which the transaction was approved. In spelling out the underlying facts Northway also brought out that during 1968 Madison had purchased National debentures which were publicly offered through underwriters in October, 1968 and that it also purchased certain National Common Stock during 1968.

Northway also argued that the purchases by Madison were more prevalent at times when the market price of National Common was being used to fix an exchange ratio in other National acquisitions. Despite the extended depositions taken by Northway it found no other evidence to support its charge of collusive purchases, although Northway did suggest that there was a pattern in the purchases of National Common by National and Madison indicating that neither of them purchased during a period in which the other was purchasing.

In order to reach a conclusion of violation of the proxy rules Northway urged a Rule 10b-5 manipulation and then characterized it as a Rule 14a-9 non-disclosure because it was asserted that the alleged market rigging (if it in fact occurred) would have made the market prices shown in the Proxy State-

28. National's open market purchases of its Common Stock for the period January 1, 1966 through June 30, 1969, were set forth in the "Statements of Consolidated Stockholder's Equity" on pages 62-63 of the Proxy Statement and "Note J-Subsequent Events" on page 69 states: "From June 30, 1969 through September 30, 1969, National has purchased 27,500 shares of its Common Stock on the open market for an aggregate price of $280,000." (A. 323-24, 330)

ment misleading since shareholders were entitled to assume that the prices were the product of a free and unmanipulated public securities market.

Opposing Northway's summary judgment motion, TSC and National argued and supported with uncontroverted affidavits and deposition testimony that there was no plan or conspiracy to manipulate the market in National Common Stock; also that Messrs. Solomon and Yarmuth did not know of Madison's purchases of National Common Stock until stock transfer sheets showed they had taken place.[29] Barnett's affidavit showed that he did not know of Madison's purchases of National Common until he and other directors of Madison received regular portfolio transaction reports in their role as Madison's Board of Directors (A. 93).

District Judge McLaren found that Northway's evidence in opposition to Northway's motion succeeded in raising a genuine issue of fact as to whether the Madison purchases were in fact coordinated with those of National, although he observed there was some evidence to support an inference of coordination in purchases. However, after noting other credible, conflicting evidence, the District Judge determined that he could not arbitrarily pick the inference favorable to Northway as the moving party under Rule 56 and held that this issue must remain for the trier of fact. 361 F. Supp. at 116.

The Court of Appeals agreed, though apparently reluctantly, that collusion was not established. 512 F. 2d at 336. Nonetheless, the court below went on to find that what was established, though falling short of collusion, was suggestive of manipulation and should have been put in the Proxy Statement for the TSC stockholders to judge from those facts whether a manipulation had occurred!

The proposed transaction called for an exchange of National Warrants and Series B Preferred Stock (not Common Stock), for TSC Common Stock and Series 1 Preferred Stock. There

29. A. 103, 105.

is no evidence in the record that any of those securities were purchased by National or Madison. There is no evidence of a direct relationship between the market price of National Common and National Warrants. Northway's own expert, Professor Nemmers, treated the Warrants as "highly speculative" and indulged in at least three different identifiable exercises trying to develop a value (A. 538). Mr. Noyes clearly refused to regard the value of the Warrants as "dependent" on the price of the Common Stock (A. 140).

As to the National Series B Preferred, all the evidence is that the determinative factors were its dividend, yield and/or coverage (A. 136; 160-63; 199-201). National did not purchase any of its Common Stock in the market from September 17, 1969, to December 18, 1969, almost two weeks after the stockholders' meetings of December 5, 1969 (A. 90).

Apart from Northway's argument, there is nothing in the record that either National or Madison Fund purchased National Common for any reason other than their own respective proper corporate or investment purposes, unilaterally and independently determined, and there is a dearth of evidence that either sold any stock so purchased or otherwise engaged in manipulation. There was no showing that any purchase by either National or Madison, or all of such purchases, materially affected the market price of National Common on any day, week or month, or in any way affected the trend of high and low sales prices fully and fairly disclosed on page 10 of the Proxy Statement.[30]

The court below also failed to appreciate that any such disclosure would compel National in effect to try, via proxy material, the fact or issue of collusion before a jury of shareholders, because to disclose bits and pieces of circumstantial evidence, without denying the inference of collusion, would invite a stockholder to draw the worst possible inference on the basis of a lopsided disclosure.

30. A. 107, Chart facing 108.

CONCLUSION.

For the foregoing reasons TSC and National respectfully urge that the decision and judgment of the Court of Appeals for the Seventh Circuit on liability of these Petitioners be reversed and that the judgment and Order of the United States District Court denying Respondent's motion for summary judgment as to liability of corporate defendants be reinstated.

Respectfully submitted,

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November 20, 1975.

APPENDIX.

SECURITIES EXCHANGE ACT OF 1934, SEC. 14(a), 15 U. S. C. § 78n(a).

§ 78n. Proxies.

(a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title.

SECURITIES AND EXCHANGE COMMISSION, RULE 14a-9, 17 C. F. R. § 240.14a-9.

§ 240.14a-9 False or misleading statements.

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

(b) The fact that a proxy statement, form of proxy or other soliciting material has been filed with or examined by the

Commission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein or any matter to be acted upon by security holders. No representation contrary to the foregoing shall be made.

NOTE: The following are some examples of what, depending upon particular facts and circumstances, may be misleading within the meaning of this section:

(a) Predictions as to specific future market values, earnings, or dividends.

(b) Material which directly or indirectly impugns character, integrity or personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation.

(c) Failure to so identify a proxy statement, form of proxy and other soliciting material as to clearly distinguish it from the soliciting material of any other person or persons soliciting for the same meeting or subject matter.

(d) Claims made prior to a meeting regarding the results of a solicitation.

SECURITIES AND EXCHANGE COMMISSION,
RULE 12b-2(j), 17 C. F. R. § 240.12b-2(j).

(j) *Material.* The term "material", when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before buying or selling the security registered.

SECURITIES AND EXCHANGE COMMISSION,
RULE 405(a), (f) and (n), 17 C. F. R. § 230.405(a), (f) and (n).

§ 230.405 Definitions of terms.

Unless the context otherwise requires, all terms used in §§ 230.400 to 230.494, inclusive, or in the forms for registration have the same meanings as in the act and in the general rules and regulations. In addition, the following definitions apply, unless the context otherwise requires:

(a) *Affiliate.* An "affiliate" of, or a person "affiliated" with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

* * * * *

(f) *Control.* The term "control" (including the terms "controlling", "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

* * * * *

(n) *Parent.* A "parent" of a specified person is an affiliate controlling such person directly, or indirectly through one or more intermediaries.

FEDERAL RULES OF CIVIL PROCEDURE, RULE 56(a), (b) and (c).

Rule 56.

SUMMARY JUDGMENT.

(a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in his favor upon all or any part thereof.

(b) For Defending Party. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.

(c) Motion and Proceedings Thereon. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

Supreme Court, U. S.
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No. 74-1471

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SUPREME COURT, U.S.

In the

Supreme Court of the United States

October Term, 1975

TSC INDUSTRIES, INC., A Delaware Corporation, NATIONAL INDUSTRIES, INC., A Kentucky Corporation, And TSC INDUSTRIES, INC. (Formerly Named NII, INC., And Being The Successor To The Business, Assets And Corporate Name Of Said TSC INDUSTRIES, INC.), A Delaware Corporation,

Petitioners,

vs.

NORTHWAY, INC., A Delaware Corporation,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit.

RESPONDENT'S BRIEF

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1975

No. 74-1471

TSC INDUSTRIES, INC., A Delaware Corporation, NATIONAL INDUSTRIES, INC., A Kentucky Corporation, And TSC INDUSTRIES, INC. (Formerly Named NII, INC., And Being The Successor To The Business, Assets And Corporate Name Of Said TSC INDUSTRIES, INC.), A Delaware Corporation,

Petitioners,

vs.

NORTHWAY, INC., A Delaware Corporation,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit.

RESPONDENT'S BRIEF

Respondent, Northway, Inc. answers the brief of Petitioners National Industries, Inc. and TSC Iudustries, Inc. as follows.

QUESTION PRESENTED FOR REVIEW

The sole question presented and available for review by this Court should be:

Whether the evidence in the record below, establishing without genuine controversy the omission of numerous admitted and uncontroverted facts from the proxy statement, evaluated in the light of the contents of the proxy statement and the governing regulatory policies, was sufficient to establish a violation of Rule 14a-9 as adjudicated by the entry of partial summary judgment on the issue of liability?

STATEMENT OF THE CASE

The origins of this litigation are in the terms of the exhange offered by National Industries, Inc. (National), a defendant below and petitioner here, for the purchase of all the assets of TSC, Inc. (TSC), the defendant-petitioner in whose right this derivative action was brought.

National was an active and voracious conglomerate, having acquired some twenty-five companies in take-overs during the five years preceding this acquisition. A.285-98. TSC was a successful retailer operating some 221 stores, and had been formed by merger in early 1968. A.298-99.

In January, 1969 National acquired from TSC's principal stockholders, the Schmidt family, approximately 34% of TSC's preferred and common stock for cash and notes totalling about $23 million. Eight months later, in November, 1969, National and TSC joined in issuing the proxy statement at bar (A.259), offering to acquire all the assets of TSC in exchange for National B preferred stock and warrants exercisable at $21.40 per share, to buy National common (National common was then selling at

about $10.00). Based on November 7, 1969 market prices shown in the proxy statement the securities so offered to the TSC stockholders who held 66% of the TSC stock had a nominal value of only $27 million.

The terms of the exchange gave the TSC shareholders 45% of their total consideration, at market values, in the form of warrants which gave them no position as equity holders or earnings participants in National (A. 312), and which would require them to pay some $53 million to attain an equity and earnings position. A.530 n.j. The warrants expire in October, 1978, and since their issuance, the market price of the National common has never approached the exercise price of $21.40. To the extent of these warrants, the acquisition was accomplished at no cost to National, with no dividend obligations or equity dilution.

The transaction was intentionally arranged as a taxable transaction for the benefit of National which had a $10 million capital gain on other transactions to offset. The paper loss in this acquisition from itself of its TSC shares amounted to $13 million (Pl. Ex. 327-328)[1] and produced an actual cash saving to National of some $3.5 million. Peterson, a TSC shareholder who was also a

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[1] Exhibits, depositions and other documents which appear in the Joint Appendix are cited "A. .....". Exhibits which do not appear in the Joint Appendix are cited "Pl. Ex. ....." for Plaintiff's Exhibits and "Def. Ex. ....." for Defendant's Exhibits. All exhibits are bound in numerical order in 22 acco binders. Vol. 1 lists all exhibits.

Depositions which do not appear in the Joint Appendix are identified by name of deponent, date of deposition and page number.

director, was bought out for cash and notes because of the the capital gain he would incur in the exchange. In consequence he abstained from voting as a director on the proposed transaction. A.414. The non-director shareholders were left to deal with their tax problems as best they could.

Aggrieved by the gross inadequacy of the consideration paid by National in taking over TSC's assets and the substantial unfairness of the transaction to TSC's public shareholders, the owner of Northway, Inc. (a family investment corporation established by Saul Fellars[1] when he sold his small group of drug stores and retired) consulted legal counsel, and this action was filed derivatively, on the basis of Northway's 200 shares of TSC, on the day before the scheduled TSC shareholders meeting to vote the proxies on the proposed sale. Several other TSC shareholders intervened as plaintiffs, but are not participating in this appeal.

After completing discovery in obedience to the District Court's direction, including discovery on damages, Respondent filed its motion for partial summary judgment as to liability, relying on four documentary and uncontroverted factual grounds. The District Court denied the motion, but recognizing reasonable grounds for differences of opinion on controlling questions of law, made the requisite findings to permit interlocutory appeal under § 1292(b) of the Judicial Code, 28 U.S.C. §1292(b) (1948). The Court of Appeals unanimously reversed on three of the grounds, finding it therefore unnecessary to consider

[1] Mr. Fellars died during the pendency of this litigation, and his widow is now sole owner of plaintiff Northway.

the fourth,[1] and directed the entry of partial summary judgment on liability in accordance with the motion. The facts relevant to the grounds relied on by the Court of Appeals are stated in the Argument.

[1] The fourth ground of the motion for summary judgment not passed on by the court below arose on the following facts which present a pure question of law:

The proxy statement repeatedly states that the TSC board of directors has approved the proposed transaction involving the dissolution of TSC upon the sale of all its assets. A. 259, 265, 267. This recital was false. Under the applicable Delaware law, the shareholders could not be called upon to vote on corporate dissolution without the prior "adoption of a resolution to that effect by a majority of the whole board" of directors. 8 Del. Code Ann. §275 (1969), quoted in full at 512 F.2d, 337 n. 25. It is admitted that the "whole board" consisted of ten members; only four voted to approve. A. 411, 414.

Under these circumstances, there was no legal foundation for submission of the question to the shareholders, and the whole proxy solicitation was a sham. This ground entitles plaintiff to summary judgment, with no need for consideration of the recitals of the proxy statement or of the materiality of its nondisclosures. When the requisite board vote has not in truth been attained, no proxies may be solicited. See *Dillon* v. *Berg,* 453 F.2d 876 (3 Cir. 1971), affirming 326 F.Supp. 1214 (D.Del. 1971); *Dillon* v. *Scotten, Dillon Company,* 335 F.Supp. 566 (D.Del. 1971).

The Court of Appeals declined to reach this clear-cut question in view of the plain adequacy of the several other grounds for its holding that the proxy statement was misleading as a matter of law. 512 F.2d, 337. The opinion nonetheless notes, and quotes at length, the views of the authority principally relied on by the District Court, who explained that the District Court was in error in its interpretation of Delaware law. 512 F.2d, 337 n. 26, 27.

Respondent has not devoted a part of this Brief to argument of the point in light of the position taken by the Court of Appeals. However, Respondent does not thereby abandon this contention.

SUMMARY OF ARGUMENT

Part I of the Argument sets forth the three grounds relied on by the Court of Appeals for its holding that the proxy statement at bar issued by both petitioners jointly was materially misleading in violation of the securities laws, and that in consequence, respondent is entitled to summary judgment as to their liability. The joint proxy statement failed to disclose, among others, three categories of undisputed facts. These facts were of critical importance to TSC's shareholders in considering National's buy-out proposal which they were being urged by their directors and management to accept; facts bearing upon the apparent values being offered; the reliability of the market for the securities involved, and the independence of their own management and directors who were urging acceptance of the proposal. Part I contends that any one (and hence, all) of the three areas of undisputed facts omitted from the joint proxy statement is sufficient to support the judgment as a matter of law.

The first ground, considered in subpart A, pp. 12-24, is as follows: The proxy statement informed the TSC stockholders that the brokerage firm of Hornblower & Weeks-Hemphill, Noyes "had rendered a favorable opinion as to the fairness to the stockholders of TSC" of the terms of the deal which was considered by TSC's directors in approving it, and that the firm had considered among other things "the substantial premium over current market values represented by the securities being offered to TSC stockholders . . . ." The Hornblower firm had written TSC a letter to this effect, dated October 16, 1969. Based upon then current market prices listed in the proxy statement for the National convertible preferred stock and common stock warrants being offered there ~~did not~~ appeared to be an apparent "substantial

premium" — 27% for the TSC preferred and 22% for the TSC common.

But approximately two weeks before the date of the proxy statement the Hornblower firm on October 31, had written a letter to Mr. Yarmuth, National's president and chief executive and chairman of TSC's Board of Directors. This letter informed petitioners that in rendering its opinion, Hornblower concluded that the National warrants which comprised nearly half of the total apparent consideration to be received by the TSC stockholders, had a value not of the current $5.25 market price of the then listed National warrants, but of only $3.50. Taking the National warrants at $3.50 reduced the apparent premium to nearly nothing. Yet petitioners failed to reveal the later letter in the proxy statement and thus presented to the TSC stockholders only half of the Hornblower opinion.

Having chosen to tell the favorable part of the Noyes opinion and call attention to the apparent substantial premium based on current market prices, petitioners were obliged to reveal the full story. They cannot use as an excuse for not doing so an attempted distinction not supported by the letters between the "price" and "value." Nor can they use as an excuse ~~its~~ their claim that a single, indivisible opinion was really two opinions. Further, National cannot use as an excuse that the portion of the opinion embodied in the later letter was to be used only for "booking" the transaction or for accounting purposes. It was not used or intended to be used for tax purposes. If it was used, or intended to be used for "booking" the warrants, or for accounting purposes, these facts themselves were of key significance to the TSC stockholders and they were entitled to be told, but were not told, about them.

Part B, pp. 24-36, argues that the proxy statement was materially misleading in setting forth the market prices of the National securities and the closing prices on November 7, 1969 without disclosing the following: National had on its payroll Edward Merkle, president and chief executive of Madison Fund, a large NYSE closed end investment fund. In addition, Bernard Barnett, Nation's board chairman, was a director of Madison. During the two-year period preceding the issuance of the proxy statement and continuing to the very week that the terms of the transaction were being set, Madison and National made market purchases of approximately 260,000 shares of National common and $2,000,000 in National bonds convertible into common. During the period from National's acquisition of its 34% of TSC's stock from the Schmidts to the issuance of the joint proxy statement at bar, the purchases amounted to 8½% of the total trading ~~value~~ volume on the exchange. Madison purchases comprised as much as 66% of total market ~~value~~ volume in one week and National purchases comprised as much as 35%. In the three weeks immediately prior to the October 16, 1969 TSC directors meeting at which the deal was approved — also the period in which the terms of the exchange were fixed — Madison's purchases were 15%, 18% and 10% of the total weekly trading. The proxy statement failed to disclose any of the admitted facts concerning the relations between National and Madison or their purchases of National's common stock. Accordingly, the proxy statement was materially misleading in this respect.

There is no need, as National claims, for respondent to prove National-Madison collusion or a National motive to affect the market prices of the National securities. The TSC stockholders were entitled to have the facts presented so that they could draw their own inferences.

The third independent ground relied on by the Court of Appeals is set out in Part C, pp. 36-62: National and TSC had filed three reports with the SEC in each of which it was stated that National "may be deemed a parent of TSC" under SEC regulations. These SEC regulations, expressly adopted by petitioners, made clear that National as a "parent" had "control" of TSC, that is, it possessed "the power to direct or cause the direction of the policies and management" of TSC. Neither these reports, nor the statements contained therein, were revealed in the proxy statement. Moreover, the proxy statement failed to reveal that National's president had become chairman of the TSC board and therefore under TSC by-laws its chief executive officer and that National's executive vice president had become a member of TSC's executive committee.

Nevertheless the proxy statement without informing the TSC stockholders of the SEC reports, or of the key TSC positions held by top National officials, informed the TSC stockholders that TSC urged TSC stockholders "to mark your proxy FOR" the deal. The proxy statement by such omissions failed to make the full disclosure of the possible conflict of interest of TSC management. Such nondisclosure was contrary to the decisions of this Court in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972) and contrary to other authorities.

Such omissions, moreover, were explicitly condemned by this Court in *Mills* v. *Electric Autolite Co.*, 396 U.S. 375 (1970) where this Court sustained a summary judgment as to liability for a similar omission. A similar result is appropriate here, particularly since the facts at bar are even more compelling than those in *Mills*.

Part II of the brief, pp. 62-87, contends that the admitted nondisclosures, as a matter of law, violate the

proxy rules under any reasonable test of materiality. Subpart A, pp. 62-72, argues that consistent with this Court's holding in *Mills* the purposes and policies of the securities laws impose the most rigorous duty of full and fair disclosure in a joint management proxy statement urging approval of a buy-out proposal being made by the principal stockholder. Such a standard appears to be appropriate on several grounds: a proxy statement is a "full story" document. The proxy statement at bar, moreover, was written to induce the TSC stockholders to accept the National deal. In such a proxy statement half truths cannot be tolerated. Also relevant are the fiduciary relationships arising in part from top National management holding key TSC executive positions. Relevant, too, is the fact that a proxy statement is corporate suffrage in action. Intelligent exercise of the shareholder's franchise requires the full story.

The Court of Appeals correctly applied the test of materiality laid down by this Court in *Mills*. (Subpart B, pp. 72-87)

The basic concept, however the definition may be phrased, is whether a matter is important enough, in light of the legislative purpose, that the stockholders should be informed. Each of the three grounds relied on by the Court below clearly meets this test. Hence gossamer distinctions whether a matter "might be" or "would be" considered important by a shareholder are of no consequence here.

Under the cloak of arguing the definition of materiality, petitioners here seek to add as a further impediment to summary judgment a requirement that respondent prove "causation" or the probable effect of the omissions on the outcome of the vote. This Court in *Mills*, for sound reasons, rejected such a requirement. Petitioners should not be heard to advance contentions already found meritless.

ARGUMENT

I.

THE PROXY STATEMENT WAS MISLEADING AS A MATTER OF LAW ON THREE SEPARATE AND INDEPENDENTLY SUFFICIENT GROUNDS.

This case turns upon the facts. They are established without controversy by petitioners' admissions, records, and documents. The legal questions involved are neither novel nor complex, and are authoritatively answered by the clear sufficiency of the documentary evidence to establish at least three clear-cut nondisclosures and half-truths, in plain violation of the proxy rules, and particularly Rule 14a-9 of the Rules and Regulations promulgated by the SEC under the authority of §14 of the Securities Exchange Act of 1934, 15 U.S.C. §78n (1934). Any one of the three violations would, standing alone, support the judgment below. The nondisclosures concern the three matters of most vital interest to a shareholder who receives a proxy statement requiring him to vote on an offered exchange of securities: the gain he will receive in market values by making the exchange; the reliability of the market for the securities he will receive in the exchange; and the disinterestedness of the advice he is offered by his own corporate management and directors on the advisability of accepting the offer.

A.

THE PROXY STATEMENT WAS MATERIALLY MISLEADING IN URGING NOYES' OPINION OF A "SUBSTANTIAL PREMIUM OVER CURRENT MARKET VALUES."

1. The Court of Appeals Properly Held That Presentation Of Only The Favorable Portion Of The Noyes Opinion Constituted An Obvious Violation.

The proxy statement stated (p. 6)that the firm of Hornblower & Weeks-Hemphill, Noyes "had rendered a favorable opinion as to the fairness to the stockholders of TSC" of the terms of the deal. "In such opinion," the proxy statement added, "said firm considered, among other things, the substantial premium over current market values represented by the securities being offered to TSC stockholders . . . ." (A. 267).

The Proxy Statement presented (A. 271) the market prices on November 7, 1969 of the National and TSC securities, including the price of the National warrant: $5.25. From these prices the TSC stockholders could readily compute the apparent "substantial premiums over current market values." The premiums thus appeared to be about 27% for the TSC preferred, and 22% for TSC common.[1] Hence, on the prestige of a leading investment

[1] Computations are:

	TSC Preferred	*TSC Common*
National "B" Pfd. (at 16⅝)	$ 9.98 (.6 sh.)	$ 8.31 (.5 sh.)
National Warrant (at 5¼)	5.25	7.88 (1½ war.)
	15.23	16.19
Less TSC Market (pfd. 12); Common 13¼)	12.00	13.25
Apparent Premium	$ 3.23	$ 2.94
Percent Apparent Premium	27%	22%

banking firm, TSC's shareholders were encouraged to believe that this "substantial premium" was, in its opinion, "represented by the securities being offered" to them.

The language quoted above emphasizing the "substantial premium" was taken directly from the Hornblower opinion letter dated October 16, 1969 (A. 427) and presented to the TSC Board at its meeting on that date by Blanke Noyes, a TSC director and a partner of the Hornblower firm. (A. 411-13) But at Yarmuth's request[1] Noyes had written him a second letter dated October 31, 1969 (A. 519) in which he explained that in giving its opinion Hornblower had valued the National warrants, not at the current $5.25 market price, but at only $3.50.

The letter states in part regarding the value as of October 9 (when the terms were set) of the "warrants to be issued in connection with [National's] proposed acquisition of TSC Industries" (A. 427):

> "Our evaluation of these warrants was made from the point of view of the stockholders of TSC Industries, of which I am a director. In advising TSC as to the fairness of the offer from NII it was necessary to determine whether the value of the warrants was reflected by the market price of the outstanding 487,000 warrants on the day in question. We did so in the light of the fact that approximately 2.6 million additional warrants would be issued in connection with the acquisition.
>
> "After studying price relationships of other warrants traded publicly, referring to customary systems of warrant evaluation, and considering the particulars of the proposed acquisition, we concluded that the warrants in question had a value of approximately $3.50."

[1] Neither Yarmuth (Yarmuth dep. September 10, 1971, p. 58) nor Noyes (A. 156) could recall the reason for the request.

Neither this letter, nor the $3.50 warrant valuation was revealed in the Proxy Statement.

Disclosure of the omitted portion of the Hornblower opinion valuing the warrants at only $3.50 would have made plain to TSC's shareholders that the apparent "substantial premium" was illusory. The warrants appeared to comprise about 48% of the value of the total package offered to TSC common shareholders, and about 34% of the total value being offered to the TSC preferred shareholders. Noyes' $3.50 value, used in place of the $5.25 market price eliminated nearly 80% of this apparent premium, and reduced it to a matter of pennies. For the holder of TSC common stock, the actual premium, in the light of Noyes' full opinion, would amount to 31¢.[1] In the aggregate, for the TSC common and preferred shares combined, the full Noyes' opinion would have revealed a total premium of less than 5%, and of some $4½ million less than the Proxy Statement advertised.

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[1] The reduction in the apparent premium is calculated as follows:

	TSC Preferred	*TSC Common*
Apparent Premium (fn p. 12)	$ 3.23	$ 2.94
Less reduction on revaluation of warrant from $5.25 to $3.50	—1.75	—2.63
Reduced apparent premium	$ 1.48	$ .31
Percent Apparent Premium	12%	2%

The total reduction in apparent premium for the 511,838 shares of TSC preferred, and 1,332,870 shares of TSC common not held by National was $4,401,164.

If a TSC shareholder discounted Noyes' $3.50 value for the National warrant by as little as a quarter of a point (25¢), the offered exchange ratio would have appeared to represent an absolute *loss* for TSC common shareholders.

The District Court erroneously denied summary judgment for this half-truth *not* because of any doubt about materiality, but because it was not "aware [of] evidence in the record" to support the fact that a warrant value of $3.50, as evaluated in the unfavorable portion of Noyes' opinion, rather than the $5.25 price listed in the proxy statement, "results in a very small premium, rather than the substantial one claimed." Pet. A. 43, 361 F.Supp. 108, 116. Since no evidence—but only simple arithmetic—was needed to show the evaporation of "substantial premium," the Court of Appeals did not hesitate to conclude that the omitted facts constituted a gross and "obvious" violation of the proxy rules. Pet. A. 17-18, 512 F.2d 324, 335.

2. The Proxy Statement's Emphasis on a Substantial Premium Over Current Market Values Concealed the Unfavorable Half of the Noyes Opinion.

The fact of first importance to a shareholder facing an exchange offer is what it appears he will get in exchange for what he gives. Playing upon the TSC shareholders' natural and keen interest in their possible gain in the offered transaction,[1] the proxy statement assured them that "the investment banking firm of Hornblower & Weeks-Hemphill, Noyes rendered a favorable opinion as to the fairness to the stockholders of TSC" of the proposed exchange, and that this firm's opinion was based upon, among other things, "the substantial premium over

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[1] Yarmuth recognized this fact. He testified in his deposition (September 10, 1971, p. 39): "Of course we were well aware of the fact that when you acquire the remaining shares you have to acquire it to the advantage of the ontstanding .stockholders of the company, and we were trying to formulate various way in which to give the TSC stockholders more than they had at the time, otherwise we couldn't have acquired the stock."

current market values represented by the securities being offered to TSC stockholders . . . ." A. 267. It appeared to the TSC's shareholders, therefore, that they were being offered what the Hornblower firm regarded as a substantial 27% premium for the TSC preferred and 22% for the common with the National warrants being reflected at the $5.25 market price.

This clearly induced impression was but half true. To the knowledge of both petitioners joining in the Proxy Statement, it was the opinion of the firm expressed orally by Noyes at the October 16 TSC directors' meeting, that "some decline in the price of the warrants" (A. 413) should be expected. Prior to issuing the Proxy Statement, moreover, National and TSC were expressly admonished in the October 31 letter that it was *not* the opinion of Noyes' firm that "the value of the warrants was reflected by the market price of the outstanding warrants on the day in question", that is, $5.25. A. 519. On the contrary, they were told it was the opinion of the firm, "[A]fter studying price relationships of other warrants traded publicly . . . that the warrants in question had a value of approximately $3.50." A. 519. But the TSC shareholders being urged to accept the deal were not told this vital fact.

3. Having Chosen to Use Part of Noyes' Opinion, Petitioners Were Obliged to Reveal the Full Story.

It is unnecessary for the Court to decide here whether the mere listing of the warrant market prices, with no added inducement of reliance, would itself have been misleading without the addition of an appropriate cautionary note to the proxy statement's market-price schedules (A. 271) Such a caution, for example, might warn the reader that quoted prices for the limited number of warrants

already outstanding could not be taken as reliable indicators of the value of the warrants to be issued in the future, when the volume would be increased six-fold.

Nor is it necessary to decide here whether the reference to a "premium . . . represented by securities being offered" in the future would constitute a *per se* violation of the proxy rules, even if full disclosure were made, because it embodied a prediction of "specific future market values", singled out in the Notes to Rule 14a-9 as the first example of what may be misleading.[1] At the very least, the issuers were fully warned by the regulations that they were treading on dangerous ground in opening the subject of a "substantial premium", measured by market values, of "securities being offered" at a future date when and if the proposed transaction was approved.

Certainly, they were under no obligation to mention any market premium. But in any event, they could not reveal a piece of the story and then take refuge as petitioners seek to do (Pet. Br. 38) behind a policy cautioning against telling any of it, to hide the parts they prefer to conceal.

As the Court of Appeals put it, petitioners "chose to publish the good news and omit the bad news." 512 F.2d 335, Pet. A. 17.

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[1] 17 CFR §240.14a-9 Note (a). The District Court considered this question as doubtful, but concluded "that the implicit prediction of post-transaction market values here should be governed by the usual standards under Rule 14a-9 rather than upon what would amount to a *per se* test based upon Note 1 to the rule." Pet. A. 43-44, 361 F.Supp., 117.

4. The Proxy Statement Conceals Noyes' Distinction Between Market Value of the Warrants Already Outstanding and of Those Yet to be Issued.

National and TSC have argued here that the Court of Appeals imputed some contradiction or ambiguity in the Noyes opinion, requiring a trial to appraise his credibility. Pet. Br. 38-39. But there is no contradiction or ambiguity in the opinion considered as a whole. At the TSC Board meeting of October 16, 1969, Noyes presented a letter bearing that date, containing the quoted reference to the "substantial premium." A. 428. Noyes confirmed that this "substantial premium" language in the Hornblower opinion referred to the then current prices for National's convertible preferred and common stock warrants being offered in the exchange. A. 160, 163-4.

At the same Board meeting Noyes presented the other half of his opinion, omitted from the proxy statement. Although "there may be some decline in the price of the warrants," he advised the board orally, "the exchange offer is a fair one." A. 413. In his October 31 written response to a question from Yarmuth, Noyes gave an explanation of the cause of this probable decline and his $3.50 valuation of the warrants to be issued to the TSC stockholder (see p. 13 ante): "The fact that approximately 2.6 million additional warrants would be issued in connection with the acquisition," while there were only "oustanding 487,000 warrants" at the time. A. 519. Thus, the letter added, "it was necessary to determine whether the value of the warrants was reflected by the market price of the outstanding 487,000 warrants on the day in question." A. 519. The answer was clearly no. "After studying the price relationships of other warrants traded publicly" and other factors, "we concluded that the warrants in question had a value of approximately $3.50." A. 519.

In short, the market price of the then outstanding 487,000 warrants was not an accurate measure of the likely market price when an additional 2.6 million warrants would be outstanding. The former was $5.25, the latter, which the TSC stockholders would receive, a likely $3.50.

Cutting this integral opinion into two pieces, the proxy statement omits any reference to the value of the warrants not yet issued and thereby conceals the critical distinction drawn by Noyes between the two groups of warrants. The TSC shareholder was led to believe that in the Noyes firm's opinion the "substantial premium over current market values" was, on the basis of the $5.25 market price of the existing warrants, represented in part by the 2.6 million warrants not yet issued—a belief directly contrary to the fact. The misleading impression was enhanced by the concluding phrase, "represented by the securities *being offered* to TSC shareholders." A. 267, 428.

Kept in ignorance of Noyes' clear distinction between present and future warrants, the shareholder could make no differentiation between the *presently outstanding* warrants and the *unissued warrants* of the same type being offered to TSC stockholders in the future. The half-opinion in the proxy statement thus clearly indicated that the securities to be offered to him would carry the "substantial premium over current market values" which he was invited to compute for himself.

5. The $3.50 Value of Warrants Yet To Be Issued Was An Integral Part of Noyes' Opinion.

In a transparent effort to sweep around this plain violation, petitioners offer a newly devised argument not presented below and advanced for the first time in this Court. Now for the first time they assert that Noyes' letter of opinion dated October 31, 1969 (A. 519) bore no relation to his October 16 opinion presented to the TSC board and to the TSC shareholders in the proxy statement, but was rather a wholly independent evaluation of the warrants for the exclusive use of National.[1] The reason, they claim, that Yarmuth obtained from Noyes the October 31 opinion valuing the warrants at $3.50 was to secure Noyes' opinion of the "intrinsic value" of the warrants to be used in "booking" the transaction (Pet. Br. 36, 37, 38).

This contention simply cannot be sustained. Whatever use National may have chosen to make of this $3.50 valuation of the warrants to be issued, Noyes' purpose in writing the letter is plainly stated in the letter itself. Its second paragraph makes it clear beyond peradventure that Noyes was clarifying and explaining the basis of his opinion, for the firm, as rendered to the TSC board. The valuation of the warrants as of October 9 (the date of the conference in which the exchange ratios were settled, A. 149) "was made from the point of view of the stock-

[1] For purposes of this argument, petitioners' brief transforms Noyes from TSC's champion in bargaining with National, as portrayed by their "control" argument (Pet. Br. 29) into the private adviser of National exclusively. The recipient of the letter, Stanley Yarmuth, undergoes the same chameleon-like transformation: his position as chairman of the TSC board completely disappears, and he is described solely as "National." Pet. Br. 36, 37, 38.

holders of TSC" (A. 519), not for purposes of National's needs, and was stated to be for the purpose of "advising TSC as to the fairness of the offer." (A. 519) It was not, as National now pretends, an appraisal of "intrinsic value" for National's own "booking" purposes.

Whatever National might have wanted, what National got in this letter was an integral part of Noyes' indivisible opinion. Whatever use Yarmuth intended or made of the Noyes letter is of no consequence. Whether requested or volunteered, this letter with its $3.50 valuation was not divorced from the firm's opinion, but was on the contrary a "predicate" of that opinion as petitioners expressly admitted in their answer to the complaint. A. 52.[1]

Petitioners' attempt to create a dichotomy between the "price" and "value" of the warrants, to separate the October 31 letter from the rest of the Noyes opinion, into "two different things" (Pet. Br. 36-7), founders upon the same facts. In the first place, the attempt loads more freight than Noyes' word usage can carry: his repeated phrase "current market values" would be self-contradictory if "value" were a quality wholly distinct from market quotes. But more importantly, Noyes' letter was not concerned with the value of the warrants in some abstract or "intrinsic" sense (Pet. Br. 38), unrelated to the market. He was faced with the intensely practical question whether the market price of the already outstanding warrants

[1] Corporate Defendants' Answer, Paragraph 14(k), recites "that they admit that Hornblower & Weeks-Hemphill, Noyes predicated its opinion not only on the entire number of actively traded, existing National warrants but also those to be issued to TSC shareholders, on the basis of $3.50 per warrant rather than the then-current market price of $5.25." A. 52.

fairly reflected the worth of what the TSC shareholders would receive in the exchange in the form of the warrants not yet issued. A. 519. His answer was negative, since there would be "some decline in the price of the warrants" (A. 413) with the flood of 2.6 million more on the market. Studying "price relationships of other warrants traded publicly" (A. 519), he arrived at a figure of $3.50. He was right. When the warrants were later issued and traded on the American Stock Exchange, their market value was $3.50.[1]

What about the National contention (Pet. Br. 36-38) that it intended the Noyes' $3.50 opinion as an opinion of "intrinsic value" for "booking" a taxable transaction? National's intentions in this regard are irrelevant to the issue of disclosure of Noyes' opinion. But even accepting its relevance *arguendo*, this argument, too, will not stand analysis.

The proxy statement declared that the transaction was a taxable transaction in which National sustained a tax loss. A. 270. In the proxy statement National explained that it would incur a tax loss based on the difference between the cost to it of the TSC stock it had previously purchased and the "fair market value" on the date of distribution of the National securities it would exchange

[1] The National warrants to be received by the TSC stockholders began to be traded on a "when issued" basis on December 8, 1969, on the American Stock Exchange. The "when issued" warrant closed the first week of trading on Friday, December 12 at 3½. (Wall Street Journal quotations)

Since issuance, the market value of the warrants has continued a downward slide. Since they confer only the right to pay $21.40 for National common obtainable on the market for about $6, the warrants currently trade in the one dollar range.

for its TSC securities (A. 270). It was further explained that based on the then "current fair market value" of such securities the National tax loss would be about $9,200,000. The $9,200,000 estimate was supported by a work sheet (Pl. Ex. 329) showing a tax loss of $9,228,254 based on November 7, 1969 *market prices*—16⅝ for the National "B" preferred and 5¼ for the warrants. The transaction was purportedly approved by the National and TSC shareholders at their respective meetings held December 5, 1969. A final computation was made early in 1970, based on December 5, 1969 *market prices*, showing a tax loss of about $13,000,000 (Pl. Ex. 327 and 328). Thus Noyes' opinion of the $3.50 warrant value had nothing to do with the determination of the tax loss.

Nor is any excuse for this omission of the full Noyes opinion provided on a theory (Pet. Br. 37-8) that the $3.50 warrant value was to be used by National in putting the TSC deal on its books for other accounting purposes. It is possible that National, prior to the issuance of the proxy statement, may have intended to book the transaction, valuing the warrants at $3.50. It is possible, moreover, that somewhere in the proxy statement schedules National may have valued the warrants at $3.50, but concealed this fact from the TSC stockholders. If, as National now suggests, it did any of these things, or intended to do any of these things, it had no business selling the deal to the TSC stockholders on the basis of the higher $5.25 market price. National should not be permitted to play up market value as an inducement to the TSC stockholders to approve the deal while keeping silent its intention to "book" at a far lower price.

The proxy rules are directed precisely at deceptive solicitation, and no citation of authority is needed to

establish that deception of the magnitude at bar constitutes a clear violation of the securities laws. In *Schein* v. *Chasen*, 478 F.2d 817 (2 Cir. 1973), a revised estimate of earnings which reduced the prediction by twenty-odd percent was sufficient to impose liability on those who had failed to disclose the revised opinion. See also *Chris-Craft Industries* v. *Piper Aircraft Corp.*, 480 F.2d 341 (2 Cir. 1973), where the shareholders were given book values without disclosure of the opinion that book exceeded probable market value of the assets.

Here the joint proxy statement exploits the Noyes observation of a substantial premium at current market values, with its plain propensity to affect the voting process and to garner shareholder approval. Having put forth half the truth because of its materiality in their favor, the petitioners cannot be heard to say that the whole truth is immaterial.

B.

THE PROXY STATEMENT WAS MATERIALLY MISLEADING IN URGING NATIONAL MARKET PRICES TO INDUCE TSC SHAREHOLDER APPROVAL WITHOUT DISCLOSURE OF THE ADMITTED MADISON-NATIONAL STOCK PURCHASES AND AFFILIATIONS.

The admitted substantial purchases of National common by Madison Fund (a large closed-end mutual fund listed on the NYSE) and by National, and the affiliations between them, constituted additional undisclosed facts which were critically important to the TSC shareholder faced with the necessity of making his decision and casting his vote. Like the omitted portion of the Noyes opinion, these undisclosed market activities related to the soundness and reliability of the market prices exploited by the proxy

statement and urged upon the shareholders as factors important to their decisions. Again, the Court of Appeals correctly ruled that these nondisclosures constituted a clear violation of Rule 14a-9. 592 F.2d 333-34, 335-36, Pet. A. 18-19.

1. The Omitted Facts Concerning These Substantial Purchases and Affiliations Were Critically Important to the Reliability of Market Prices as Decisive Factors.

The basic and operative facts are not in dispute. In urging a favorable vote, under the heading "Boards of Directors Approval", the proxy statement repeatedly calls attention to "recent market prices of the securities" (first paragraph, A. 267), "the current market prices of the securities", and "the substantial premium over current market values" (second paragraph, A. 267), as basic to the favorable opinions of both the TSC board and Noyes' investment banking firm. This emphasis on market prices is followed quickly by a full page devoted to a tabular presentation of comparative prices with quarterly highs and lows for the years 1968 and 1969, and the current New York Stock Exchange closing prices on November 7, 1969. A. 271.

These blandishments are not accompanied, however, by any disclosure of the fact that during the same two years, National and Madison had purchased some 260,000 shares of National common and $2 million in National bonds convertible to common (A. 547, 549, 558), that National's board chairman (Bernard Barnett) was also a director of Madison, and that Madison's president and chief executive (Edward Merkle) was a paid employee of National. A. 520, 522, 38, 51.

Merkle, while serving as President and chief executive of Madison, was carried also as a salaried employee of National, with special options for 10,000 National common,

Under his employment agreement Merkle agreed "to provide at least one day per month" for such duties as might be requested by National. A. 520. Two days before he purchased $2 million in National bonds convertible to common, for Madison's account, his National salary was increased five-fold, to $12,000. A. 522. Thus, Merkle's secret arrangement called for a salary of as much as $1,000 per day.[1]

The Madison-National purchases of National common were substantial. They amounted to 8.5% of the total trading volume on the Exchange in the period beginning after National's acquisition of the Schmidt shares and ending with the issuance of the proxy statement. A. 547. In particular weeks of this period, the percentage of total weekly trading represented by Madison or National purchases reached highs of 66% and 35%, respectively, and in a majority of the weeks in which either traded, their purchases exceeded 10% of total weekly trading. A. 545-47.

During the three weeks immediately preceding the October 16, 1969 TSC directors meeting to approve the terms of its sale to National, Madison's purchases of National common amounted to 15%, 18%, and 10% of the total weekly trading. A. 546-47. This, too, was the period during which both of the meetings with Noyes took place and in which the final terms of the deal were fixed. A. 141-47.

The importance of this information to a consideration of the fairness of the transaction to TSC's shareholders is obvious. Like the TSC shareholders and the SEC,

[1] Yarmuth, National's chief executive, and Merkle were long standing friends. Yarmuth hired him as his "financial adviser". (Yarmuth Dep. December 16 & 17, 1971 pp. 11-15).

Noyes and his partners were not aware of these facts. They were not told of the payments being made to Merkle or the substantial purchases of National's common by Madison Fund. A. 173-74.

Madison's purchases were disclosed to Noyes during his deposition, and he was asked if knowledge of them would have made any difference in the Hornblower opinion with respect to the fairness of the transaction. His answer, though reluctant, was a clear recognition of the importance of this information. "I can't answer that question off the cuff," he said, "[i]t would require a good deal of study . . . ." A. 176-77.

These omitted facts were critical to any intelligent evaluation of the significance of the market quotations urged upon the TSC shareholders. Established by National's own records and uncontested in the courts below, these facts were not disclosed in the proxy statement.[1] But they had a vital bearing on the reliability of the market quotations which TSC's shareholders were being asked to consider in appraising the deal and the apparent "substantial premium" being offered to them. A. 267, 271.

As the Seventh Circuit held, the TSC stockholders had the right to know of these facts, to draw their own infer-

[1] Petitioners' brief does not contest the Court of Appeals' sound holding that National's own purchases were not adequately disclosed by the scattered clues buried in the appendix' financial statements and their flurry of footnotes dealing with capitalization, not market prices, and more than fifty pages away from the market quotations they related to. 512 F.2d, 335 n. 20, Pet. A. 10, n. 20.

The numbers of shares purchased by National and Madison are taken from petitioners' admissions. A. 547 Note. The different figures offered in Petitioners' Brief, p. 40, are neither cited to nor supported by the record.

ences, and make their own evaluations. 512 F.2d 335-36, Pet. A. 19. Omission of these facts made the market-price sales pitch in the proxy statement materially misleading under Rule 14a-9.

2. The Significance to TSC Shareholders of These Omissions Does Not Depend Upon Collusion as a Prerequisite.

With no disclosure of these purchases by, and connections between National and Madison (facts fully known to National),[1] the TSC shareholders were left with the proxy statement's inducements to rely on market prices but without vital facts raising doubts about the reliability of that market. Because the bare facts bespeak so loudly the possibility of conspiratorial manipulation, the District Court[2] and the petitioners here (Pet. Br. 39-42) have labored under the misapprehension that Northway is arguing that collusion is established beyond controversy

[1] National's purchases of its own stock were of course known to National and to its officers (Yarmuth and Solomon) who were at the same time two of TSC's key directors. The Madison purchases were promptly reported to National, and these reports were regularly supplied to and examined by these officers. A. 225-26, 256-57. Whether they knew of each Madison purchase in *advance* (Pet. Br. 41) has no bearing on the duty to disclose.

[2] As the District Court correctly discerned, the only word in the lengthy complaint which might be construed as charging motive is "coordinated" (A. 39), used to describe the remarkable coincidental phenomenon that National and Madison never purchased shares in the same week, although National bought in ten weeks in the period and Madison in nine. But the District Court erred both in stating that plaintiff argued that defendants had a duty to disclose only if National "caused" Madison's purchases, and in holding that National had no duty to disclose potential manipulation which it was fully "aware of, but did not cause". Pet. A 42, 361 F.Supp., 115-116.

by these facts. That is not the ground of the motion for summary judgment, as the Court of Appeals properly understood. 512 F.2d 336, Pet. A 19.

The duty of disclosure does not depend upon a final factual determination that there was collusion in the National or Madison purchases, nor upon indisputable proof that they acted as petitioners claim "for any reason other than their own respective proper corporate or investment purposes, unilaterally and independently determined." Pet. Br. 42 The possibility that Merkle made Madison's purchases "unilaterally" without orders or requests from National does not destroy the importance of those purchases to the reasonable TSC shareholder.

The facts were brought to light through discovery in this case, over petitioners' determined and protracted opposition, upon public announcement of the SEC's independent proceeding against Merkle, charging him, among other things, with violating the disclosure requirements of the securities laws by causing Madison "to purchase 182,500 shares of National Industries, Inc., common stock and National convertible bonds in the principal amount of $2 million without disclosing that he was a salaried employee of National . . . ." *In re Merkle*, SEC Release 7280, Investment Company Act (1972), set out in full at A. 564.[1] The SEC did not charge "collusion" or tacit agreement. Rather, disclosure was required to alert Madison investors to Merkle's conflict-of-interest position, to allow them to judge for themselves which of his two em-

[1] The proceeding against Merkle was disposed of, upon his consent, with a finding that he committed the violations and with a 60-day suspension from any securities investment occupation. A. 5644.

ployers he was serving by the purchases. The potential influence of National's interests was a consideration equally important to TSC shareholders, and they were equally entitled to judge for themselves whether he was buying in National's interest.

3. Similarly, the Significance to TSC Shareholders of These Omissions Does Not Depend Upon Motive as a Prerequisite.

Congress, the Commission, and the courts have ruled out the superfluous additional elements which petitioners argue must be determined as facts to establish the materiality of the Madison-National purchases and connections. There is no need for a showing that the purchases were made for an evil motive, or "for any reason other than their own respective corporate purposes". Pet. Br. 42. "Neither the Commission nor the courts should be required 'to separate the mental urges' . . . for '[t]he motives of man are too complex to separate.'" *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200-01 (1963). The legislative history emphasizes that motive is irrelevant to the investor's right to be fully informed of a corporation's purchases of its own stock:

> "*Whatever the motive* behind a repurchase program, if the repurchases are substantial they will have a significant impact on the market price of the security. The shareholders of a company and other persons interested in the market price of its stock should have full information regarding the company's activities and intentions in repurchasing its own stock." Senate Report No. 550, 90th Cong., 1st Sess., p. 5 (1967). (Emphasis added.)

For the quoted reasons, it is also unnecessary to litigate as a fact question, as petitioners suggest, the extent to

which the purchases "affected the trend of high and low sales prices" (Pet. Br. 42) set out in the proxy statement. The layman, like Congress, needs no evidence to appreciate that if purchases "are substantial they will have a significant impact on the market price" (supra) and that adding 8.5% more purchases on top of existing market demand, as here, may well have invoked the law of supply and demand.

The SEC has long taken the position that its rules require disclosure of a corporation's purchases of its own stock, both to the investing public and particularly to the shareholders of another corporation who are invited to exchange their shares. In such a case, the SEC has charged that the disclosure rules are violated when an affiliated fund (a stock bonus plan) buys the issuer's common stock, or securities convertible into common, without disclosing to the shareholders of a corporation being acquired in exchange for the common stock that the Exchange price "would not reflect an independent consensus reached between buyers and sellers in a course of competitive trading, uninfluenced by the activities of the defendants."[1]

Elsewhere,[2] the SEC has forbidden the issuer of securities from making purchases of its own shares while they are being offered in an exchange to investors, premised

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[1] *SEC* v. *Georgia-Pacific Corp.*, CCH Fed. Securities Law Rep. ¶91,680 (S.D.N.Y. 1966). See also *Genesco, Inc. Prospectus*, SEC Rulings, CCH Fed. Securities Law Rep. ¶77,354 (1966). Both proceedings resulted in consent dispositions. Detailed disclosures, including daily volumes and prices, were required.

[2] Despite petitioners' reference to "market rigging", this is not a case where it is claimed that the purchases are unlawful in themselves, imposing liability to any trader in the market regardless of disclosure, as under §9(a) of the 1934 Act, 15 U.S.C. §78 (i)(a), or Rule

upon the Commission's expert conclusion that such purchases have an inherent propensity to mislead. The courts have properly refused to second-guess the SEC, or to require proof to support what the SEC has already determined by rule: that such purchases "will have a false prodding effect on the price of the distributed security and . . . the value of the exchange package." *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 378 (2 Cir. 1973).

Finally, there is no need for "evidence of a direct relationship between the market price of National Common" on the one hand, and National warrants or National B Preferred on the other. Pet. Br. 42. The warrants are nothing more than rights to buy National common at $21.40, and the preferred is convertible into three-quarters of a share of common. Again, the natural common sense of the shareholder would lead him to regard the common price as critically important to his choice, and the SEC rules confirm this conventional wisdom. The proxy rules *require* a listing of "the market value" of the common when warrants to purchase common are to be issued.[1]

The evidence here is not to the contrary. It is less than accurate to say that Mr. Noyes "clearly refused to

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(Continued)
10b-6. The plaintiff's position is rather that, however lawful, the purchases must be *disclosed* when the proxy statement urges reliance on market prices, under Rule 14a-9. The fact that Congress and the Commission have assiduously circumscribed such purchases, with limitations, prohibitions, and restrictions, nonetheless emphasizes their vital significance in the statutory scheme and their materiality as a matter of law regardless of motive or intent.

[1] Schedule 14A, Item 11(a) (iv), 17 CFR §240.14a-101. The SEC has also recognized the inextricable interrela-

regard the value of the Warrants as 'dependent' on the price of the Common Stock." Pet. Br. 42. On the contrary, Noyes testified that the market prices of National's common stock was relevant to Hornblower's considerations, "[b]ecause the value of the warrants and in part, the value of the convertible preferred were not—dependent isn't right—but related to the price of the common stock." A. 140. His further testimony makes clear that the market price of the National common was extremely important in the Hornblower evaluation of the National securities to be offered to TSC's shareholders, particularly the National common stock warrants. A. 147-48, 151-53, 157, 166-67.

Similarly, Northway's expert, Professor Nemmers, utilized the market price of National's common in valuing the warrants issued in the deal. As petitioners say, he made three analyses of these values. Pet. Br. 42. But each method of valuation employed the market price of the underlying common stock.[1] A. 539.

The SEC, pursuant to congressional mandate, has determined both legislatively and adjudicatively that purchases like those admitted here are inherently misleading. At minimum, and as a matter of law, such purchases, singled

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(Continued)
tions by prohibiting the issuer from purchasing a security (National common) when other securities convertible into it (National B preferred) or exchangeable for it (National warrants) are being offered in a distribution. Rule 10b-6(b), 17 CFR §240.10b-6(b).

[1] National's expert, Mr. Stiegelmeier, did not make an evaluation of the National warrants. However, even he testified that valuing the National warrants would require "[a]mong other things . . . a rather careful study of the common stock to which these refer." Stiegelmeier Dep. November 24, 1971, pp. 45-46.

out for a special condemnation and concern by Congress and the SEC, must be regarded as material, and must be disclosed.

4. The Congressional Purpose Protects the Shareholders' Right to Draw Their Own Inferences From the Admitted Facts.

The more basic fallacy of petitioners' argument is its pervasive premise: that there is no duty of disclosure as a matter of law so long as different inferences can reasonably be drawn from the admitted facts. Pet. Br. 27-8. The unstated assumption underlying the argument is that there would be no violation of the proxy laws if a jury concluded after trial that plaintiff had failed to prove that Merkle colluded or conspired with National, to prove that the reasons for the purchases were manipulative, or to prove that the market for National warrants or preferred was actually boosted by the common purchases.

The notion that these issues are committed to judicial determination is contrary to the whole thrust and purpose of the congressional plan. The enactment of §14(a) "stemmed from a congressional belief that '[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange.' H.R. Rep. No. 1383, 73rd Cong. 2nd Sess. 13. The provision was intended to promote 'the free exercise of the voting rights of stockholders,' . . . [to] effectuate the congressional policy of insuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions." *Mills* v. *Electric Autolite Co.*, 376 U.S., 381 (1970).

In keeping with this policy, it is the *shareholders,* not the courts, who are vested with the power to decide whether the transaction should be approved. They are

entitled to decide for themselves whether to repose their confidence in questionable market quotations. The possibility that a jury might conclude after a trial that the market was or was not reliable does not deprive the shareholders of their congressionally conferred right to judge for themselves, with full disclosure of suspicious circumstances. Any other rule "would allow the stockholders to be bypassed. . . . A judicial appraisal of the merger's merits could be substituted for the actual and informed vote of the stockholders." *Mills* v. *Electric Autolite Co.*, 396 U.S., 381 (1970).

As here, when the admitted facts establish without genuine controversy an undisputed factual foundation of vital importance to reasonable TSC shareholders in making their decision, the congressional purpose demands that the shareholders' right to draw the inferences—favorable or adverse—must be protected. Thus petitioners' concluding characterization of the decision below is not so anomalous as they suppose; the congressional policy, in this sense, *does* "compel National in effect to try, via proxy material, the fact or issue [of conflicting inferences] before a jury of shareholders . . . ." Pet.Br. 42. The passage describes, fairly if metaphorically, the necessary effect of any disclosure law, requiring full and fair revelation of the material facts. *Mills* v. *Electric Autolite Co.*, 396 U.S. 375, 384 (1970). If, as here, adverse inferences are obvious, these may be denied in the proxy statement or accompanied by countering facts.

Here, the District Court was wrong in concluding that disclosure was required only if there had in fact been a joint rigging of the market and that only the jury had the right to draw such inferences from the undisputed facts. 361 F. Supp 116. The Court of Ap-

peals correctly divined the congressional objective: "But the purpose of 14a-9 is to allow the stockholders to draw such inferences as they see fit before their final decision on proxy questions."[1] 512 F.2d, 336. Pet. A 19.

C.

IT WAS A VIOLATION OF THE PROXY LAWS TO FAIL TO REVEAL TO TSC STOCKHOLDERS SIGNIFICANT FACTS FROM WHICH THEY MIGHT HAVE INFERRED NATIONAL CONTROL OF TSC.

1. The Proxy Statement Failed to Reveal Key Reports to the SEC and Key TSC Positions Held by Top National Executives.

Both National and TSC filed key reports with the SEC in which each made statements of critical importance

[1] With disclosure of the Madison-National purchases and relationships, a reasonable shareholder might have concluded, without inquiring further, that the circumstances were sufficiently suspicious that he wanted nothing to do with National or its securities. Or the stockholder—or his broker, investment adviser, the Exchange, or the SEC—might have chosen to look deeper, discovering that although National and Madison made purchases in nineteen separate weeks between National's acquisition of the Schmidt shares and the proxy statement, they never bought in the same week (A. 550); that purchases were concentrated in periods when National common was weak or when National released unfavorable earnings statements (A. 550-51, Notes E, F, and 552, Note L); and that purchases were also concentrated in critical periods in National's active campaign of corporate acquisitions, when the market price of National common would fix exchange ratios and determine the attractiveness of the offered transactions to the target shareholders. (A. 553, Note M, 554-57, Notes Q, V, W, X, Z, AA, BB, CC, and FF).

These facts stand undisputed in the record. The Court of Appeals correctly called attention to some of them in reaching its conclusion that the TSC shareholders were entitled to draw their own inferences.

concerning National's control relationships. On February 27, 1969 TSC filed its Form 10-K Annual Report as required by Section 13 of the 1934 Act. A.509. In response to Item 3, TSC stated

> "National Industries, Inc. may be deemed a 'parent' of the registrant [TSC] within the meaning of the rules and regulations of the Securities and Exchange Commission adopted under the Securities Act of 1933." A.512.

March 7, 1969, TSC filed its Form 8-K Current Report under the same Section 13. In response to Item 1 referring to changes in control, TSC specifically referred the SEC to this statement in its earlier 10-K. A.517. National made substantially the same statement to the SEC in its Schedule 13D filed February 14, 1969.

There is no ambiguity in this recital. Translated from legalese, the statement that "National may be deemed a 'parent' of TSC . . . as defined" means plainly that "it is permissible and correct to regard and to think of National as controlling TSC, that is, as possessing the power to direct TSC's management and policies."[1] There

[1] The key terms are defined in Rule 12b-2, 17 C.F.R. §240.12b-2, issued by the SEC under the Securities Exchange Act of 1934. Rule 12b-2(k) defines "parent" of a specified person as follows:

> "A 'parent' of a specified person is an affiliate controlling such person directly, or indirectly through one or more intermediaries."

The definition of an "affiliate" of a specified person is in Rule 12b-2(a):

> "An 'affiliate' of, a person 'affiliated' with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified."

can be no doubt about what the recital meant. The definition of "parent" expressed by both National and TSC is clear. To be the parent of TSC meant that National controlled TSC—whether that power was exercised or not.[2]

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[1] (Continued)

Finally, "control" is defined in Rule 12b-2(f):

> "The term 'control' (including the terms 'controlling,' 'controlled by' and 'under common control with') means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

National's filing was under the Securities Exchange Act of 1934. It refers in its filing, however, to a "parent" as defined in the Securities Act of 1933. The SEC definitions of "parent," "affiliate" and "control" under the 1933 Act are identical to those under the 1934 Act. See Rule 405 under the 1933 Act, 17 C.F.R. §230.405.

The use of "deemed" to describe National's parenthood means simply that not literally but for purposes of the law it may be so regarded. *Cf.* 28 U.S.C. §1332(c) (a corporation is "deemed to be" a citizen); §1348 (a national banking association is "deemed to be" a citizen of the state where it is located).

[2] Petitioners' two affidavits, like the affidavits of no-influence filed by defendants in *Mills,* 403 F.2d 429, 434 (7th Cir. 1969), "miss the point". The correct question under the regulatory definitions is not whether National is "*in* control" (Pet. Br. 33) in the sense of giving daily orders, but rather whether National has "possession, directly or indirectly, of the power to direct or cause the direction of the management and policies" of TSC. 17 C.F.R. §240.12b-2(f). Once that power is possessed, there is no need to go further "'to separate the mental urges' . . . for '[t]he motives of man are too complex . . . to separate.'" *SEC* v. *Capital Gains Research Bureau,* 375 U.S. 180, 200-01 (1963).

The joint proxy statement, however, did not disclose the fact that these statements had been made to the SEC. Neither National's nor TSC's filings were disclosed. The proxy statement, moreover, did not explicitly state that National could be deemed to be the parent of TSC, or to control it, or to possess the power to direct its management and policies.[3]

Further, the joint proxy statement did not disclose key facts concerning the positions in TSC's management and on the Board of Directors held by the top executives of National. It was not disclosed that Stanley Yarmuth, a National director, its President and chief executive, was also the chairman of TSC's Board and therefore its chief executive officer under its by-laws. A. 445, 180. Also undisclosed, moreover, was the fact that Yarmuth was a member of TSC's 5-man executive committee. A. 467. Nor was it disclosed that Charles Simonelli, National's Executive Vice President and a member of National's executive committee, was also chairman of TSC's Executive Committee. A. 471.

These omitted facts were of vital importance to TSC's shareholders. They were being told in the joint proxy statement that their directors had approved National's proposal. A. 259, 267. They were being urged by their management to vote for the deal. A. 259. But they were not told these facts which had a crucial bearing on the potential conflict of interest and lack of independence of their own advisors, their own directors and own manage-

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[3] In contrast, however, a prospectus for the sale of 195,000 shares of TSC common, dated March 18, 1969, eight months before the proxy statement at bar, did state to potential investors that National may be deemed a parent of TSC. Pl. Ex. 106, p. 21.

ment—who were urging their acceptance of the transaction.

2. The Securities Laws Demand Full Disclosure of a Possible Conflict-of-Interest Position of One Offering Investment Advice.

The federal securities laws enacted in 1933 and 1934 rely upon disclosure as the principal means "to preserve the climate of fair dealing which is so essential to maintain public confidence in the securities industry and to preserve the economical health of the country." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963). "A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry." 375 U.S., 186. In elevating these ethical standards, Congress focused upon conflicts of interest as a key concern. See Senate Report No. 1455, 73d Cong., 2d Sess. 12 (1934).

This Court, heeding the congressional concern, has directed full disclosure of a conflict-of-interest position occupied by one who undertakes to offer advice to a securities investor, declaring in *Capital Gains Research* that the recipient of the advice "must, if the legislative purpose is to be served, be permitted to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether an adviser is serving 'two masters' or only one . . . ." 375 U.S., 196

The same policy underlies the holding of this Court in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), that defendants Gale and Haslem, acting merely in an advisory and ministerial capacity, bore

a duty to disclose their conflict-of-interest position. "The defendants may not stand mute . . .", under Mr. Justice Blackman's opinion for the Court. "The seller had the right to know that the defendants were in a position to gain financially from their sales . . . ." 406 U.S. 153.

In this respect, the securities laws demand the same ethical standard traditionally imposed by courts of equity upon fiduciaries, compelling in all instances full disclosure of a conflict-of-interest position. "Courts have imposed on a fiduciary an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts' " including "disclosure of a conflict-of-interests." *SEC* v. *Capital Gains Research*, 375 U.S. 180, 194, 196 (1963). Here both corporations who joined in issuing the proxy statement bore an exacting duty. TSC's management and board of directors which included National's top executives, stood as fiduciaries of the shareholders' interests, and owed the utmost candor. This obligation was heightened by their voluntary undertaking not merely to report formal board action approving the transaction, but to offer advice and recommendations to the shareholders, urging them to vote for the sale. Clearly, important facts concerning this potential conflict of interest, and revealing that National may be in control of TSC were of vital concern to TSC's shareholders in considering the urgings of their own board and management to accept National's proposal.

3. A Possible Control Relation with the Adversary in a Proposed Transaction Must Be Disclosed to the Shareholders.

The supervening importance of control to the disclosure policies of Congress and the Commission is mirrored in

the practicalities of the workaday world of the investors and shareholders who are protected by these disclosure policies. In practicality, no factor is more important to the investor or shareholder than control.[1] The TSC shareholders who were being asked to accept National's deal could make no intelligent decision without knowledge of these facts indicating that National may be in charge, and on both sides of the bargaining table.

Petitioners' joint proxy statement stated that National had acquired 34% of TSC's voting stock, and that five of the ten TSC directors were National's nominees, while the remaining five holdovers were "not affiliated with National." A.267-68.

With no more information than this, the TSC shareholder was implicitly assured that the terms of the offered buy-out had been hammered out in equal bargaining between evenly divided factions, and were the best that could be attained by forceful representation of TSC's interests. In this light, he could safely repose his confidence in the assurance, on the cover page of the proxy statement, that TSC's "Management urges you to mark your proxy FOR this purchase of TSC assets by National . . . ." A.259.

The TSC shareholder was also lulled to believe that the "Board of Directors Approval", heading the proxy statement's critical page (A.267), contained within it the favorable votes of the five holdover directors who had no National affiliation. He had no cause to scrutinize the deal for himself, but could safely entrust his interests to these directors who, he was repeatedly told, "are of

[1] See Cohen, *A Note on Takeover Bids and Corporate Purchasers of Stock,* 22 Business Lawyer 149, 151 (1966).

the opinion that this acquisition is in the best interests of the shareholders" (Cover Page, A. 259), and who "have approved the Agreement and believe that the transactions contemplated thereby are in the best interests of the shareholders of both corporations . . . ." A. 267.

This confidence-inspiring portrayal takes on a very different color, however, if one omitted fact is added to the picture: TSC's own management has officially reported to the SEC that TSC is properly to be regarded as subsidiary of National, and under National's control. In plain terms, TSC's management had declared that it may be considered to be under the control of National. The issue of control was not "hotly disputed." Pet. Br. 34. The management of TSC was not resisting a National takeover and asserting independence; they had recognized expressly that TSC's "management and policies" were properly considered to be subjugated to National's "power to direct." There was no need for "any clear-cut battle" to determine who had control. Pet. Br. 33.

TSC's shareholders had vital need to know of these statements to the SEC. They were entitled to consider these omitted facts in deciding how to vote on the National proposal. With this disclosure, the TSC shareholder would have confronted a very different question in deciding how to vote. He could no longer take it on faith that TSC's management had obtained, in tough arms-length bargaining, the best possible terms for TSC. Once it is revealed that his bargaining representatives have reported themselves as being possibly subservient to the domination of the opposing interests of National, a grave and inescapable doubt arises about which side of the table they sat upon. Any presumption in favor of the offered bargain must then, in caution, be reversed,

to view the offered terms not as the best attainable, but rather as the least the offeror, National, thinks it can get by with.[1]

As the terms of the bargain struck become suspect with the disclosure of facts indicating National's possible control, so too does the advice of TSC's directors and management to accept them. The recommendations of your

[1] Petitioners' brief paints a portrait of Noyes as the tough bargainer, representing TSC's interests so vigorously that National acceded to his terms without argument or protest. See Pet. Br. 29-30. This argument, of course, is not relevant to the issue of disclosure of the statements made by both TSC and National concerning National's control relationship.

Moreover, with due warning, the reasonable TSC shareholder might have viewed the picture differently. Noyes' firm had received the benefit of being retained, after National's control was reported, as principal underwriter for a secondary offering of TSC stock originally planned for the purpose of selling Schmidt's shares. When that plan was aborted by Schmidt's sale to National, the offering was salvaged by "management's" decision to substitute treasury shares, with substantial commissions to Noyes' firm. A. 34, 51. The firm had previously received a $20,000 fee for approving National's terms for acquiring another subsidiary (Hawthorn-Mellody) as "fair and equitable." A. 34, 51. The shareholder might also have found it to be odd and unusual that the "bargaining" was conducted by Noyes and his partners, with no TSC officers or employees who were not also top National executives present at the meetings. A141-42, 151, 158. He might reasonably question whether they had conducted a thorough canvass for outside, competitive offers for TSC's assets, or whether the Noyes' firm was acting not as bargainer but rather at most as an impartial, objective appraiser of the offer, retained solely to render an expert opinion. A.267. Or he might fairly consider the possibility that Noyes' firm was in reality advising National on the minimum plausible offer, and that National offered no resistance because its own adviser was speaking.

adviser cannot be intelligently evaluated in ignorance of his recorded admission that your antagonist in the transaction may well have the power to call the shots. The "urgings" of management and the "opinion" and "belief" of the TSC board of directors were both inherently and irretrievably misleading without disclosure of the fact that TSC had made prior reports of National's possible control, or at least of the substantive content of those reports. TSC management's own understanding of its relationship to National was of vital importance to those whose proxies were sought, since an "adequate disclosure of this relationship would have warned the stockholders to give more careful scrutiny to the terms of the merger than they might to one recommended by an entirely disinterested board." *Mills* v. *Electric Autolite Company*, 396 U.S., 375, 384 n. 6 (1970).

4. The Potential Conflict of Interest Inherent in the Omitted Statements Concerning National's Possible Control Was Accentuated by the Position of TSC's Directors as Employees of National's Reported Subsidiary.

To the shareholder who is asked to vote on a proposed sale of his corporation's assets, a possible control relationship between his corporation and the prospective purchaser is vital information, critically important to his choice in any case. In this particular case, however, control carried a unique and unusual significance. Four of the five holdover directors of TSC, represented as "not affiliated with National" (A.268), were executive officers in the employ of TSC and its affiliates.[1] With

[1] The offices of Schaefer, DeForest, and Carl Sharfman are recited at page 7 of the proxy statement. A.268. A careful reader could find Peterson's office described on the preceding page. A.267.

disclosure of National's possible control, these four are revealed as potentially beholden to National for their jobs and their livelihood.[2] Once it is known that National may be deemed TSC's parent, then these four officer-directors are revealed as employees of a National subsidiary, who can no more be described as "not affiliated with National" (proxy statement, p. 7, A.268) than director Segell who, as an officer of a National subsidiary, was excluded from the "non-affiliated" group. A. 267-68.

Even for *outside* directors, otherwise independent, nondisclosure of a previous concession of control would render their proxy statement fatally misleading in reciting their approval and in urging the shareholder to accept their favorable recommendation and advice. That nondisclosure rises to a vastly different and higher level of significance, however, when all the supposedly independent directors (but one) are employees of a corporation

[2] The reality of this dependence is exemplified by the situation of Carl Sharfman, who was relieved of his duties as a TSC executive after National took control, and was then rehired in October, 1969, a few days before he was called upon to vote as a TSC director, on October 16, for the sale of all TSC assets to National. A.57.

Petitioners' attempt to characterize Mr. Schaefer as "aggressive" and, working with Noyes, as having negotiated the terms of the transaction on behalf of TSC and its shareholders. Pet. Br. 29. This assertion is irrelevant to the issue of nondisclosure here and the shareholders' right to be adequately informed of material facts.

Moreover, the assertion is not supported in the record. Schaefer had been installed as TSC's president, to serve at the pleasure of the board. A.466. Schaefer was not at either the October 2 or October 9 meeting where the terms of the deal were discussed and fixed. (Dep. of Noyes, May 12, 1970, pp. 67-69 and 134). By his own testimony, Schaefer did not know the terms of the transaction until it was presented to the TSC board at its October 16 meeting. Schaefer Dep. March 25, 1971, pp. 565-71.

which potentially stands in the hidden status of a subsidiary to the opposing party in the transaction. With that revelation, the taint runs both deeper and wider, rooted in plain self-interest, and reaching beyond the recommendation of the officers as *directors* to their advice—and the terms of the transaction they bargained for—as *management*.

5. Nondisclosure of the Key Management Positions in TSC Occupied by National Executives Was Unlawfully Misleading.

Nondisclosure of the key management positions in TSC occupied by National's principal officers operated to conceal a separate but similar conflict of interest affecting TSC's management, and the proxy statement was thereby misleading from its first page inducement: "Management urges you to vote FOR this purchase of TSC assets by National . . . ." A.259.

Who was this "management"? The shareholder was not told that Stanley Yarmuth, chief executive officer and president of National, had been installed as chairman of the board of TSC, making him TSC's chief executive officer under its by-laws, empowered to "supervise and control all of the business and affairs of the corporation." A.445, 180. The shareholder was not told that Charles Simonelli, National's Executive Vice President and a member of the Executive Committee of National's board of directors (A.305), had also assumed the chairmanship of TSC's Executive Committee, with Yarmuth as another member. That Committee was vested generally with "the powers of the Board of Directors in the management of the business and affairs of the corporation" with stated exceptions. A.467.

In short, the TSC shareholder was urged by his "management" to vote approval. But he was not told that to a substantial degree, that same management was identical with National's management, with the same persons at the same time occupying the same key offices in both corporations.[1]

To the reasonable shareholder, the clear importance of this management identity was not dependent, either in law or in common sense, upon proof of the extent to which the powers of control possessed by these dual officers were in fact exerted in the day-to-day issuance of orders. Under the official definitions incorporated by reference by both National and TSC in their reports to the SEC, "control means the *possession,* directly or indirectly, *of the power* to direct or cause the direction of the management and policies . . . ." 17 C.F.R. 240.12b-2(f); 230.405 (f). The vital fact, as a matter of law, is "possession of the power", whether or not exercised at the moment, and its importance does not flash on and off intermittently depending upon who made today's decisions. Common sense confirms the wisdom of the regulatory definition. The good subordinate does not need daily orders. He knows the side his bread is buttered upon, and exercises his delegated responsibilities in accordance with the policies and interests of his superior.[2]

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[1] Although the proxy statement describes in detail the offices and affiliations of *National's* management A.305-06, the shareholder is provided with no comparable description of his *own* management, tendering him advice, despite the requirements of Schedule 14A, Item 4(a)(1).

[2] As Yarmuth explained to the TSC board, in Schaefer's presence, Schaefer as TSC's president was "the chief *administrative* officer" (emphasis added), not the chief executive. Schaefer's testimony reflects his understanding in this regard. He was not chief executive officer of TSC. He operated the Company on a day to day basis subject to the TSC Board (which included National's top executives) and the Chairman of TSC's Board, Yarmuth. He exercised the responsibility which in his opinion had been delegated to him. A.196. He felt as if he were the chief executive and that National had exercised the same confidence in him as they would in any chief executive officer. A. 197.

A.467

Of course. Yarmuth and Simonelli could not operate all of National's subsidiaries on a day to day basis. Authority obviously had to be delegated to others, like Schaefer, to conduct the ongoing administrative supervision of these various diversified operations. A.285-286.

Conceivably, the admitted omission of these undisputed facts could have been regarded as "cumulative", as petitioners contend (Pet.Br. 31), if the proxy statement had contained a clear and unequivocal disclosure that National and TSC both had agreed in SEC reports that National may be deemed to control TSC. Without that disclosure, however, no reasonable shareholder could make an informed valuation of the recommendation urged in the name of his "management" not knowing who spoke in that name. The hand was the hand of TSC, but the voice was the voice of National.

The Court of Appeals was thus eminently correct in holding that in any event, the combined[1] nondisclosures of the SEC reports and of "the crucial positions held by National nominees Yarmuth and Simonelli on the TSC board of directors were materially misleading within the meaning of §14(a) of the Securities Exchange Act of 1934 and Rule 14a-9 thereunder as a matter of law."

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[1] To divide and conquer, petitioners artifically separate these interrelated nondisclosures, to assert that either alone is insufficient to sustain the judgment below, but ignoring the combined effect. Pet.Br. 29, 32.

512 F.2d, 333. Nothing less would serve to "effectuate the congressional policy of ensuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions." *Mills* v. *Electric Autolite Company,* 396 U.S., 385 (1970).

6. The Judgment of the Court of Appeals Was Required in Obedience to Mills v. Electric Autolite.

Six years ago this Court considered *Mills* v. *Electric Autolite Company,* 396 U.S. 375 (1970), presenting the same basic question now before the Court: Whether the shareholder-plaintiff is entitled to partial summary judgment on the issue of liability upon a documentary showing that needed shareholder votes for a corporate acquisition had been obtained through a proxy statement offering the favorable advice of the target's management without disclosing a prior report to the SEC that the acquiring corporation stood in a control relationship over the acquired corporate target. This Court unanimously held that liability is established by such a showing, and reversed the Seventh Circuit's denial, on causation grounds, of partial summary judgment for the shareholders. The Court declined to review the sufficiency of the evidence to establish a material violation, 396 U.S., 381 n.4, but Mr. Justice Harlan, for the Court, restated at length the rationale of the Seventh Circuit's conclusion that this omission was material and that the nondisclosure constituted a serious violation of law (396 U.S., 384, n.6):

> "In this case, where the misleading aspect of the solicitation involved failure to reveal a serious conflict of interest on the part of the directors, the Court of Appeals concluded that the crucial question in determining materiality was "whether the minority shareholders were sufficiently alerted to the board's relationship to their adversary to be on their guard."

> 403 F.2d, at 434. An adequate disclosure of this relationship would have warned the stockholders to give more careful scrutiny to the terms of the merger than they might to one recommended by an entirely disinterested board. Thus, the failure to make such a disclosure was found to be a material defect "as a matter of law," thwarting the informed decision at which the statute aims, regardless of whether the terms of the merger were such that a reasonable stockholder would have approved the transaction after more careful analysis. See also *Swanson* v. *American Consumer Industries, Inc.,* 415 F.2d 1326 (C.A. 7th Cir. 1969)."

These conclusions were the foundation for this Court's ruling that causation had been established by the materiality of the omission, and for its order of remand, directing the entry of partial summary judgment for plaintiffs. Faced with the same basic factual pattern in this case, the Seventh Circuit paid proper heed to the lesson taught by this Court in reversing *Mills.* Identity of facts requires an identical result, and the judgment below was correct under the controlling authority of *Mills.*

The controlling facts in *Mills* are directly matched by the facts here. There the acquiring corporation (Mergenthaler) had reported to the SEC that it was in a position of control over the target. Nondisclosure of this necessarily tainted the favorable recommendation of the target's board of directors, in the proxy statement addressed to their shareholders, since the directors owed their membership on the board to Mergenthaler, whether its nominees or not, and were retained because it was "considered in the best interests of Mergenthaler that they continue . . . ." *Mills* v. *Electric Autolite Company,* 403 F.2d 429, 434 (7 Cir. 1969), reversed on other grounds, 396 U.S. 375 (1970). Here control by National has been

repeatedly reported to the SEC, explained by definition as meaning that National had "power to direct . . . the management" of TSC. The advice of TSC's management and directors was thereby subject to the same taint.

7. The Proxy Statement Here Involves More Serious Violations Than the Nondisclosure in Mills.

This *Mills* minimum is enough. But the case established by the facts here is emphatically stronger, in at least five respects.

(a). Disclosure of National's Ownership of 34% of TSC's Stock Was Not a Full and Fair Disclosure of Possible Control.

The proxy statement involved in the *Mills* case disclosed that the acquiring corporation already owned 54% of the Autolite stock. To a mathematical certainty, that percentage foreclosed the possibility that control could reside anywhere else. Here the percentage owned by National was only 34%, leaving open the interpretation, as pictured in petitioners' brief, pp. 32-34, that the "old TSC management" had retained control by support from among the 66% of the shares not owned by National. With *Mills* holding that a statement of the percentage of stock owned does not excuse nondisclosure of a prior report of control to the SEC, even at 54%, it follows *a fortiori* that the proxy statement here was materially defective despite 34% disclosure. As this Court observed in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963), "what is required is 'a picture not simply of the show window, but of the entire store . . . not simply truth in the statements volunteered, but disclosure.'"

(b). The Advice of the TSC Board of Directors Was Tainted Not Only by an Undisclosed Claim of Control as in Mills, but also by the Directors' Positions as Employees.

This case is stronger than *Mills* in a second critically important aspect considered above. Here, four of the five ostensibly "non-affiliated" directors of TSC were in fact employees of TSC, who would be revealed, with disclosure of National's reported control, as beholden to National for their jobs, their promotions, and their raises in salary. They cast three of the four votes on TSC's board approving the sale of TSC's assets to National. A. 411-414.

In *Mills*, by contrast, the four directors not nominated by the acquiring corporation were all outside directors, with full-time employment elsewhere, and only two of the seven non-interlocking directors were employees of the target. Appendix, *Mills* v. *Electric Autolite Company*, No. 64, October 1969 Term, pp. 654-55, 658-65. In *Mills*, the prior report of control to the SEC was sufficient to raise "a serious conflict of interest on the part of the directors" (396 U.S., 384 n. 6), although independently employed. This is an *a fortiori* case.

(c). The SEC Reports Here, Triggered by a Change of Control, Were Material as a Matter of Law.

A still more important difference between this case and *Mills*, making nondisclosure here markedly more significant, emerges from the nature of the SEC reports filed in the two cases. In *Mills*, the acquiring corporation claimed to have been in control for a period of two or three years before the solicitation, and voluntarily filed an application for a declaration that it was exempt from the provisions of the Investment Company Act of 1940, 15

U.S.C. §80a-3. The crucial statement claiming control was submitted merely as evidence bearing on only one of the several requirements for exemption.[1] 403 F.2d, 429, 434.

Here, in contrast, the SEC reports were not volunteered but required by law, and had as their primary and dominant purpose the reporting of control. Form 8K, filed by TSC on March 7, 1969 (A.517), was required by Section 13(a) of the 1934 Act, 15 U.S.C. §78m, and Rule 13a-11, 17 C.F.R. §240.13a-11, promulgated under its authority by the SEC, to compel immediate disclosure of specified highly significant changes, occurrences, and events which have a major impact on corporate securities being traded in the markets. Among the critical events triggering such special current reports are such significant occurrences as a default in making a payment on major corporate indebtedness, withdrawal of assets securing bonds or debentures, and disposition of more than ten per cent of the corporation's total assets. Form 8-K Instructions, Items 6, 5, and 2. But the first item in this listing, assuming pre-eminent importance, is "Changes in Control of Registrant", calling for an immediate report of the name

[1] The parallel is completed here by the fact that National, too, had obtained such an exemption in 1964, on the ground that its purchases of stock in other companies, pursuant to its acquisition program, constituted not "investments" but the acquisition of "control." Continued validity of that exemption was conditioned, under the law, upon the continued existence of "the circumstances which gave rise to the issuance of an order" granting exemption. Inv.Co. Act §3(b)(2), 15 U.S.C. §80a-3(b)(2). The exemption was thus prospective, and required that future acquisitions, including the purchase of the TSC shares from Schmidt, constitute the acquisition of control. The Court of Appeals below by-passed the nondisclosure of these facts found to be fatal in *Mills*, because of the surpassing importance of the SEC reports involved here. (* Inv. Co. Rel. 4024)

of "any person who has become a parent of the registrant. . . ." Item 1(a). Form 8-K Instructions.

The important fact is thus that the 8-K report was filed as required under these provisions and not merely, as in *Mills,* the subsidiary facts recited in the report. The material fact is the filing of the report itself, not only its content.

The other reports of control by National and TSC, while not directly triggered solely by the change in control, evidence a similar emphasis upon the critical importance of this event. Schedule 13D, filed by National on February 14, 1969 (A.471), was required by the Act because National had acquired more than 10% (subsequently amended to 5%) of TSC's stock, as petitioners state. Pet.Br. 32, 34. But National was required to go further, and to disclose "any plans or proposals" it might have to liquidate or to merge TSC, or to sell its assets, *only* "(C) if the purpose of the purchases [of the Schmidt stock] is to acquire control of the business" of TSC, under §13(d)(1)(C) of the 1934 Act, 15 U.S.C. §78m(d)(1)(C). National answered Item 4 on Schedule 13D (A.490), by stating it *had* obtained control. It recited that it may be deemed a parent of TSC, and then proceeded to set forth its "plans and proposals"—information required only when the purpose of the Schmidt purchase was the acquisition of control.[1]

[1] Since the date of National's filing, Item 4 of Schedule 13D has been amended by the Commission to extend the congressional command of §13 of the Act, and to require "the purpose of the transaction to be disclosed in every Schedule 13D, regardless of an intention to acquire control . . . . See 17 CFR §240.13d-1-101 (1974)." *Rondeau* v. *Mosinee Paper Corporation,* ..... U S. ....., n. 1, 45 L.Ed. 2d 12, 17 (1975).

Form 10-K, filed by TSC on February 27, 1969 (A.509), also emphasizes the importance, in the regulatory scheme, of a change in control. The report is to be filed annually, and must disclose any parent of the reporting issuer. This item need not be answered, beyond a reference to the previous report, if there has been no change in control. However, TSC reported such a change in the same terms adopted in the other reports: National may be deemed a parent of TSC. A.512.

Congress and the Commission have thus singled out a change in control as a matter of special importance, requiring prompt action to notify the SEC. To make the information more accessible to the investing public, reports of all three kinds must also be sent to each securities exchange on which is listed any security of the controlled corporation.

These reports all are required pursuant to the provisions of §13 of the 1934 Act, 15 U.S.C. §78m. They are vital and integral parts of the overall statutory scheme, with compliance enforced by criminal sanctions. Section 14 of the Act, dealing with disclosure to shareholders when proxies are solicited, works in tandem with its adjacent Section 13, commanding interim and periodic reports of vitally important information. Any event singled out in the congressional scheme as demanding a special report under §13 must be viewed, in interpreting §14, as material in the eyes of the legislature and accordingly, as a matter of law. The report's contents, legislatively established as of surpassing importance, should be restated and revealed as material facts in a subsequent proxy statement. At minimum, a decent regard for rational consistency in the statute, read as an organic whole, demands disclosure of the fact that such reports have been made.

(d). The SEC Reports Here, Filed by the Target Corporation as Well as by the Insurgent, Carry Direct and Critical Significance.

The report of control found to be material in *Mills* was submitted solely on behalf of the acquiring corporation. Under the authority of that decision, the reported belief of the insurgent that it has control is a material fact, and nondisclosure in a proxy statement for a merger with the target is a clear violation of the proxy rules, entitling the misled shareholders to the entry of partial summary judgment on the issue of liability as a matter of law.[1] This much is established by *Mills.* And Northway's position here would be fully established if there had been no other SEC reports beyond National's Schedule 13D.

But here that ample showing is only part of the matter, and the stronger part, beyond *Mills,* lies in the fact that TSC had twice reported National's control position. A claim of control from the acquiring side of the transaction does not, in theory, exclude the argument advanced by petitioners that the target possibly may refuse to acquiesce in the status of a subsidiary. Pet.Br. 33. But here, far from refusing to acquiesce in this control status, TSC itself reported the same control relationship to the SEC.

This fact was of signal importance to the TSC shareholders. Their own adviser had recognized National's domination and the pull of divided loyalties. Once TSC's management had admitted its conflict-of-interest position, by reporting its concession that National may be the parent, the shareholder must be warned, and allowed to judge for himself, "through appropriate disclosure, . . . whether an adviser is serving 'two masters' or only one,

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[1] This was precisely the holding in *Colonial Realty Corp.* v. *Baldwin-Montrose Chemical Co.,* 312 F.Supp. 1296 (E.D. Pa. 1970), relying on this Court's opinion in *Mills.*

'especially . . . if one of the masters happens to be economic self-interest.' *United States* v. *Mississippi Valley Co.*, 364 U.S. 520, 549." *SEC* v. *Capital Gains Research Bureau*, 375 U.S. 180, 196 (1963).

(e). Reasonable Consistency in the Interpretation of Section 13 and 14 of the 1934 Act Requires That the Proxy Statement Disclose Prior Reports of a Change of Control.

This case is stronger than *Mills* in still another respect. After the proxy solicitation there, the SEC amended its proxy rules and regulations in 1966 to require explicitly the disclosure of "a change in control of the issuer [which] has occurred since the beginning of its last fiscal year . . . " This requirement was added as Item 5(e) of Schedule 14A, Information Required in Proxy Statement, and under Rule 14a-3, proxy solicitation is forbidden unless the proxy statement contains this information.[1]

It would seem reasonable, at minimum, to regard this new requirement simply as a link between Sections 13 and 14 of the 1934 Act, making explicit what is already plain from the statutory scheme: that a change in control which triggers special prompt reports under §13 should be disclosed in any subsequent proxy statement. In its practical application to the typical situation, Item 5(e) would thus ask, in effect, whether any special report of a change in control has been made in the past year.

Overlooking this modest and obvious purpose, the District Court chose instead to treat Sections 13 and 14 as wholly unrelated, uncoordinated, and inconsistent, and as authorizing defendants to "assert that National was not,

[1] Petitioner's Brief, 34, might be read as erroneously ignoring this Rule.

in fact, in control of TSC within the meaning of Item 5(e), notwithstanding the statements to the contrary in the SEC filings." Pet.A.33, 361 F.Supp. 108, 111. This remarkable and erroneous judicial stamp of approval for blatant contradiction, allowing defendants to evade the plain command of Item 5(e) by claiming their own reports were not true, became harmless in the Court of Appeals with that court's correct decision that Rule 14a-9 required disclosure of the prior reports as a matter of law.

The question of Item 5(e), however moot, serves to reveal in stark focus an unstated major premise of petitioners' whole argument here. They are asking this Court to stultify the legislative purpose and to reward dishonesty by lending its imprimatur to self-contradiction in the required disclosures under the Securities Exchange Act. Form 8-K and Item 5(e) ask precisely the same question: Has there been a change of control? Judicial approbation for opposite answers if the shoe pinches would appear to be a statement to the investing public that the special reports required by Congress have no meaning and are unworthy of any reliance or credit, since they would be freely open to contradiction and repudiation at the whim of the issuer.

Whether under Item 5(e) or the broader Rule 14a-9, a decent regard for the congressional purpose requires a rule of simple consistency in disclosures to the investor, with open avowal and explanation if repudiation of prior reports is thought to be justified. This reasonable rule serves to foster that public confidence in the securities markets which Congress sought to assure, and at the same time to promote easy and ready compliance. With prior reports at hand, the author of the proxy statement has a certain guide, and nondisclosure is necessarily a product of deliberate choice. It should not be permitted.

8. The TSC Shareholders Were Entitled by Law to Be Told What the SEC Had Been Told.

The SEC reports cannot be brushed aside as not intended to mean what they plainly say: that National controlled TSC. Form 8-K was required precisely *because* there had been a change in control,[1] and no answer to Item 4 on Schedule 13D[2] or Item 3 on Form 10-K was called for unless control was changed.[3] The question asked is half the answer, and the common recital in all three reports must be read as responsive to the question asked.

The failure to answer the same question in the proxy statement (Item 5(e), Schedule 14A) cannot be excused because the answer is only "appropriate in a required filing" with the SEC (Pet.Br. 34), and too technical for a solicitation addressed to investors as a group. As noted above, a prospectus[4] addressed to investors at large, in TSC's secondary offering made a few weeks after the SEC filings, the identical recital was set forth in the same

[1] TSC's Form 8-K report (A.517) cannot be brushed aside as merely reporting that "Schmidt's control of TSC had ceased", leaving a vacuum. Pet.Br. 32, n. 24, 34. That is simply *not* what the report said, in incorporating the statement that National had become TSC's parent. It does not even state that Schmidt formerly had control.

[2] Petitioners' brief is accurate, so far as it goes, in stating that National filed its Schedule 13D because of its stock purchase. Pet. Br. 34. *But* the answer given to Item 4 (A.490) was called for *only if* National had obtained, or intended to obtain, control. See p. 55, *supra*.

[3] TSC's Form 10-K report (A.519) required no answer to Item 3, concerning the "parent" of TSC, unless there had been a change since previous reports.

[4] Pl. Ex. 106, p. 21. This prospectus was required to disclose any "parent" of the issuer. See Form S-1, Item 8, 17 C.F.R. §230.

words, "National may be deemed to be a 'parent' of TSC as that term is defined in the rules and regulations under the Securities Act of 1933." Apparently the recital is "inappropriate" (Pet.Br. 34) only when its disclosure would reveal the inherent conflict of interest and threaten the success of the self-dealing transaction, that is, when the recipient is a shareholder who really needs to know.[1]

The recital was *not* compelled, of course, merely because National had acquired one third of TSC's stock. The reports could not be based "solely" on that acquisition (Pet.Br. 32, 33) since they would be unlawful if, in accordance with the picture painted by petitioners' brief, and by the proxy statement, the "non-affiliated" directors had chosen not to surrender, but had resisted, creating a stand-off on the equally divided board depriving National of control while the holders of the other two-thirds of the stock were rallied in a proxy contest. If that had been the true situation, or if for other reasons either National or TSC had believed that control was in doubt or was only a "possibility" (Pet.Br. 32 n. 24), they were specifically directed by the official instructions to say so.[2] But however control was reported to the SEC and to the stock exchanges, with whatever doubts or hedges, the shareholders were entitled to be told the same story.

[1] This prospectus "risked confusing shareholders" (Pet. Br. 33) at no risk to National's interest, apparently, since an outside purchaser of the new issue of TSC stock was not threatened in his decision by any conflict of interest produced by National's control.

[2] Rule 12b-22, applicable to all three reports, provides: "If the existence of control is open to reasonable doubt in any instance, the registrant may disclaim the existence of control and any admission thereof; in such case, however, the registrant shall state the material facts pertinent to the possible existence of control." 17 CFR §240.12b-22.

II.

THE ADMITTED NONDISCLOSURES VIOLATE THE PROXY RULES AS A MATTER OF LAW UNDER ANY REASONABLE TEST OF MATERIALITY.

The petition for certiorari tendered to this Court a broad and far-reaching question of the proper definition of materiality under the federal securities laws. Pet. 7. Against the compelling force of the admitted and uncontroverted facts, however, any minor refinements in the words employed to define materiality could have no effect on the result of this case. Petitioners' brief on the merits fails to demonstrate how substitution of "would" or an emphasis on "propensity" in this Court's definition laid down in *Mills,* 396 U.S. 375, 384 (1970), and reconfirmed in *Ute,* 406 U.S. 128, 154 (1972), could require reversal. The two major parts of that brief remain utterly unrelated, and there is no foundation nor justification in the factual record for nice refinements in the test of materiality which might produce a reversal punitive to respondent because of the Court of Appeals' adherence to this Court's announced test.

A.

THE PURPOSES AND POLICIES OF THE SECURITIES LAWS IMPOSE THE MOST RIGOROUS DUTY OF FULL AND FAIR DISCLOSURE IN A MANAGEMENT PROXY STATEMENT URGING APPROVAL OF A TRANSACTION FOR THE BENEFIT OF THE PRINCIPAL STOCKHOLDER.

To accept petitioners' arguments here, and to rule that these admitted half truths violate no provision of the securities laws, would emasculate a fundamental congressional policy, strengthened and reconfirmed in its forty-

year span. Protection of investors against predatory practices is both an end in itself and a vital means of ensuring the nation's economic health by nurturing the investor confidence which is essential to "the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes. . . ." *United Housing Foundation, Inc.* v. *Forman,* U.S. (1975) [95 S.Ct. 2051, 2059]. This case lies at the very heart of the basic policy, and the proxy statement here is the prototype of that "deceptive or inadequate disclosure in proxy solicitation" which Congress condemned. *J.I. Case Co.* v. *Borak,* 377 U.S. 426, 431 (1964).

1. Whatever the Proper Test of Materiality for Other Forms of Transactions, the Circumstances of These Admitted Nondisclosures Call For the Most Inclusive Standard of Materiality.

There is no quarrel with petitioners' starting point: that "full and fair disclosure of material information [is] a guiding principle" of the 1933 and 1934 Acts. Pet. Br. 18. And it is equally common ground that "materiality is the key to disclosure standards." Pet. Br. 18.

But agreement does not extend to the next step in their argument, implying that one monolithic standard of disclosure and one uniform test of materiality must be applied across the board to all the varied forms of securities transactions, between participants in all possible relationships, to all forms of communications, and under all the varied provisions of the acts and rules requiring disclosure of material information. Petitioners seem to suppose that one unvarying test must be laid down for actions under "Sections 11, 12(2) and 17 of the Securities Act and Sections 10, 14 and 18 of the 1934 Act" and "under Rule 10b-5" and "Section 14(e) of the 1934 Act."

Pet. Br. 19, 26; Pet. 7. They illustrate their proposed "uniform" standard of materiality with three examples, all extreme cases where the information was so extraordinary that a press release was immediately required to alert the investing public at large. Pet. Br. 26-27 n. 21. Of course no such question is presented in this case, there is no need to consider whether the information withheld from the proxy statement should have been broadcast at once to the world at large.

Here the Court has before it a proxy statement jointly issued by the acquiring and target corporate management urging approval of a major proposal without disclosing certain admitted facts. This Court is not called upon here to decide every possible case that may involve some question of disclosure or an issue of materiality. It is enough for decision here to note, as lower courts and commentators have observed,[1] that different considerations may call for differing standards in other cases. Such cases may range from the press release demanded to inform the trading market generally of extraordinary developments, at one extreme, to the management proxy statement, at the other extreme. Various factors, responsive to the legislative purpose, appear relevant to the proxy statement standard of materiality enunciated by this Court in *Mills*. These factors include the following:

(a). *Full-story documents.* A proxy statement is a full story document. The issuer is directed by law to furnish a written document to tell the full story as a self-contained source of all relevant information.

[1] See Ruder, *Factors Determining the Degree of Culpability Necessary for Violation of the Federal Securities Laws in Information Transmission Cases,* 32 Wash. & Lee L. Rev. 571 (1975); *ALI Fed. Securities Code,* pp. xix, xvii (March, 1973 Draft).

It has a statutory duty to speak in any event, and is forbidden to solicit proxies without a full proxy statement. The command is not simply "tell no lies"; it is rather "tell the whole truth."[1]

(b). *The Sales-talk.* Relevant also is the fact that the joint proxy statement here was written to induce the reader to enter into a transaction for the defendant's own benefit and profit.[2] When the very purpose of the document is to persuade and to influence action, the law may fairly hold the issuer to his avowed objective, and accept his sales talks as tending to accomplish its intended purpose: to sway the reasonable investor.[3]

(c). *Half truth.* It is also important to recognize the circumstances where the issuer has broached a subject and focused attention on it by furnishing a part of the facts—half the truth. Omitted facts con-

[1] Congress requires "not simply truth in the statements volunteered, but disclosure." *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 201 (1963).

[2] The legislative history on salesmanship is reviewed in *Blue Chip Stamps* v. *Manor Drug Stores,* U.S. [44 L Ed 539, 559] (1975). This Court there quotes the House Report on the subject:

> "Any objection that the compulsory incorporation in selling literature and sales argument of substantially all information concerning the issue, will frighten the buyer with the intricacy of the transaction states one of the best arguments for the provision." H.R.Rep. No. 85, 73d Cong., 1st Sess. 8 (1933).

[3] In Mr. Justice Cardozo's phrase, "The springs of conduct are subtle and varied. One who meddles with them must not insist upon too nice a measure of proof that the spring which he released was effective to the exclusion of all others." *DeCicco* v. *Schweizer,* 221 N.Y. 431, 438, 117 N.E. 807, 810 (1917).

cerning the same subject matter then assume an inevitable importance—an importance which the issuer has himself created. As here, having chosen to reveal half the facts, the issuer is in no position to contest the materiality of the remainder, nor to claim in mitigation its belief that none of the story was relevant.

(d). *Fiduciary relationships.* In an arms-length transaction between strangers, a duty of disclosure may be imposed when a disparity of knowledge results from one party's status as an insider.[1] But a more stringent duty of disclosure, and a more pervasive standard of materiality, obtains where, as here, key officials of a defendant occupy in addition the status of fiduciaries because of their positions as corporate directors and high management of the target firm. Where such fiduciary relationships exist a defendant is specially charged to make full disclosure. This is particularly true with respect to facts which have an important bearing on potential conflict of interest and independence in urging the target's shareholders to accept the proposal.

(e). *Corporate suffrage.* The proxy statement is corporate suffrage in action. The congressional purpose is to protect "fair corporate suffrage" and to prevent abuses which "frustrated the free exercise of the voting rights of stockholders." *J.I. Case Co.* v. *Borak,* 377 U.S. 426, 431 (1964).

The proxy statute and rules seek to guarantee the shareholder's right to vote as his judgment directs. Here the

[1] See *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972).

substantive merits of the offer are not controlling: the shareholders have the right to reject an advantageous exchange if they prefer the status quo, or to accept an unwise exchange if they choose. The standard of materiality should be broad enough to permit them to exercise their statutory franchise fully and reasonably.

Where, as here, the shareholder confronts an electoral process to decide whether he will become an equity holder in a different and unfamiliar corporation, full disclosure is required for all aspects of the transaction which a shareholder, in reason, might consider important in casting his ballot.[1] The joint proxy statement here invited the TSC shareholder not merely to buy and sell, but also to *vote.*[2]

(f). *Regulatory facts.* Facts singled out by Congress and the Commission carry special importance in the regulatory scheme. They must be viewed, in deference to the legislative purpose and administrative expertise, as material by virtue of the act and regulations—as a matter of law. Here the nondisclosures concern factors which have been singled out by law for special attention, regulation, and disclosure: control, market values, and market activities by the issuer and its affiliates.

[1] See SEC Securities Act Release Nos. 33-5627, 34-11733, Environmental and Social Disclosure, 40 Fed.Reg. 51656, at 51659 (Nov. 6, 1975).

[2] The dilemma confronted by the shareholder who receives a tender offer is accentuated when the communication is a merger proxy statement, putting him under the gun. For a description of the predicament, see *Rondeau* v. *Mosinee Paper Corp.,* U.S. [45 L Ed 2d 12, 20 n.8] (1975).

These matters reach to the heart of the traditional economic concerns of the securities laws, and stand in marked contrast to "environmental and other matters of social concern, including equal employment matters • • • [and] the promotion of social goals unrelated to the objectives of the federal securities laws." SEC Securities Act Releases Nos. 33-5627, 34-11733, Environmental and Social Disclosure, 40 Fed.Reg. 51656 (Nov. 6, 1975). This release explains the Commission's reluctance "to require disclosure for the sole purpose of promoting social goals unrelated to those underlying these Acts" (40 Fed. Reg., 51660). It is borrowed from its context by petitioners to furnish "a significant portion of the text" of petitioners' brief although the release plainly is devoted to such extraneous matters. Pet. Br. 18 n. 5.

In sum, here the several purposes and policies ~~coverage~~ Coverage to exact the fullest disclosure. Defendants are "the most inside of insiders",[1] and "the insider par excellence."[2] Here the proxy statement is a selling document, seeking votes on behalf of TSC's management and for the benefit of its principal stockholder (National), jointly issued to urge approval of the self-dealing sale of TSC's assets to National. Bound to tell the full story, they offer instead half truths touching the most vital factors influencing the shareholders' votes—factors emphasized by Congress and the Commission as of critical materiality. Petitioners necessarily concede that "in many cases misstatements or omissions may be so clearly material that there is no

[1] 1 Bromberg, *Securities Law: Fraud* §6.4(1) (1967).

[2] Professor Stanley Kaplan, statement in Hearings on S.510 before the Subcomm. on Banking and Currency, 90th Cong., 1st Sess., 132 (1967), quoted in *Broder* v. *Dane*, 384 F. Supp. 1312, 1319 (S.D.N.Y. 1974).

need nor occasion to focus on the standard of materiality." Pet. 10. If nondisclosures can ever be ruled to be material as a matter of law in a proper case, then this is that case.

2. The Court of Appeals Properly Adjudicated Petitioners' Violations of the Proxy Laws, and Their Consequent Liability for Appropriate Derivative Relief.

The Court of Appeals here has done no more than to declare the conclusion compelled by matching the admitted facts against the controlling law, read in light of its spirit: that the joint proxy statement violates the prohibition against misleading proxy solicitation. This judicial conclusion received strong support in the court below from the SEC as the agency of government most expert in the practicalities of achieving the legislative purpose and most sensitive to the underlying policies.

As this Court has noted, Congress has left it to the SEC to decide whether these policies "should be effected by rulemaking or by *ad hoc* adjudicatory actions . . . ." *SEC* v. *Chenery Corp.*, 332 U.S. 194, 209 (1947), "Private enforcement of the proxy rules provides a necessary supplement to Commission action . . . . serves as a most effective weapon to the enforcement of the proxy requirements." *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 428, 432 (1964). With limited staff and resources for investigating and litigating, the Commission has chosen here to seek enforcement of the policies for which it is primarily responsible by asserting its authoritative position at the appellate level in litigation privately initiated. That position is entitled to full deference.

Congress, the courts, and the Commission have joined to forbid the inference which petitioners seek to draw from their recital that the SEC staff "took no exception whatever to any of the alleged defects," (Pet. Br. 28-29,

Pet. Reply Br. in Support of Petition 8-9), when a draft of the proxy statement was examined. By §26 of the 1934 Act, Congress directly forbids such an inference: "No . . . failure to act by the Commission . . . with regard to any statement . . . filed with or examined by such authority . . . [shall] be deemed a finding by such authority that such statement . . . is not false or misleading." Securities Exchange Act of 1934, §26, 15 U.S.C. §78z. The Commission has tailored this statutory prohibition to apply specifically to proxy statements. (R. 14a-9(b)).

The reasons are obvious enough. The SEC receives more than twenty voluminous drafts of such statements every working day. An immense staff would be required to conduct a thorough field investigation in sufficient depth to discover, for example, the Madison-National relationships and purchases, or the full Noyes' opinion, neither discoverable from the filing. Of necessity, the staff's examination and review is confined to the four corners of the draft submitted, as the staff's letter of suggestions demonstrates by its content. A. 96-100.

Nor can the limited staff be charged, at this volume, with a duty to scour the Commission files for omitted facts, such as the SEC reports here, filed some eight months earlier. That point was also important in *Mills*, 396 U.S. 375 (1970), where the omission at issue was the failure to disclose facts in the Commission's files.

More importantly, the Commission itself, as distinguished from its staff, has no time to examine all such drafts nor to conduct appellate review of its staff's correspondence. The Commission is not "singing more than one song." Pet. Reply Br. in Support of Pet. 8. The Commission itself *does* decide on every position taken in its name in any litigation.

Nor can the blatant nondisclosures be passed off as mere technical oversights, inevitable slips in a good faith effort to comply. Petitioners' faint protestations in this record are equally irrelevant and unsupportable.[1]

Moreover, National was no novice in this regulatory field. In the five years preceding this deal, National had put through some twenty-five large scale corporate acquisitions. A. 285. With this know-how, their implied resort to the cover of "reputable attorneys" (Pet. Br. 28) is of no aid.

Nothing is before the Court at this time beyond the adjudication of the defendants' violation of the proxy rules, and their consequent liability. That liability involves no *in terrorem* element of threatened damages in an indeterminate amount for an undefinable, unlimited, or unforeseeable class of plaintiffs. See *Blue Chip Stamps* v. *Manor Drug Stores*, U.S. [44 L Ed 2d 539, 556] (1975). Here the action is derivative, maintained on behalf of TSC and, in practicality, for the benefit of the so-called minority who relinquished 66% of its stock, a limited, well-defined and ascertained group. The issue of appropriate relief has yet to be litigated or decided, and will be governed by traditional principles determining proper remedies. See *Rondeau* v. *Mosinee Paper Corp.*, U.S. [45 L Ed 2d 12, 23-24] (1975).

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[1] In fashioning an express civil remedy for the communication most closely analogous to the proxy statement, Congress has provided that, in an action for misleading omissions in a registration statement under the 1933 Act, good faith and due diligence are not defenses available to the corporate issuer. Securities Act of 1933, §11(b), 15 U.S.C. §77k(b) (1933). The courts apply a parallel rule under §14 of the 1934 Act. Lower court decisions are collected in Annotation, 24 ALR Fed. 241 (1975).

Here the transaction was in substance, although not in form, a corporate merger, with the former TSC shareholders becoming National holders. Plaintiffs claim derivatively that the National securities received in exchange for TSC's assets were grossly insufficient. That disparity was at the same time the TSC shareholders' loss and National's gain. In such a case, an award of damages, if appropriate, involves no potential of a ruinous or indeterminate liability to outsiders. The question is simply the fair division of the corporate pie among the family of its own security holders.

B.

THE PROPER STANDARD OF MATERIALITY WAS CORRECTLY APPLIED BY THE COURT OF APPEALS.

The petition for certiorari in this case offered a supposedly basic and unsettled question of the standard and definition of materiality under the proxy rules applicable here. That supposed question fades into insignificance in the glaring light of the proxy statement's naked half-truths on critical matters of the most vital interest to the shareholders. As respondent argued in its Brief in Opposition to the Petition 6-13, these admitted nondisclosures are of surpassing importance, beyond the reach of any minor differences in the range of varied definitions of materiality that have been employed. Under any plausible standard that might be adopted, the omissions are material as a matter of law. Accordingly, respondents have no objection to any reasonable phrasing of the standard that may be advanced by petitioners, so long as elements of reliance or causation are not thereby smuggled into the case in violation of this Court's holding in *Mills* v. *Electric Autolite,* 396 U.S. 375 (1970).

1. The Standard of Materiality Applicable to This Proxy Statement Was Clearly Laid Down by the Court in Mills v. Electric Autolite.

This Court does not write on a clean slate in considering, to whatever extent necessary in this case, the proper test of materiality. Both parties in this suit are agreed that the controlling authority on the question, as recognized by the Seventh Circuit, is to be found in this Court's opinion in *Mills* v. *Electric Autolite Co.,* 396 U.S. 375, 384 (1970), and in the subsequent reiteration and confirmation of that test in *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 154 (1972).

The Court of Appeals adhered faithfully to that binding authority, and quoted and applied its language: "whether the omitted fact is 'of such a character that it might have been considered important by a reasonable shareholder who was in the process of determining how to vote.'" 512 F.2d 324, 332. In doing so, the Seventh Circuit rejected the assertion that this Court had not meant what it plainly said, and properly declined to arrogate to itself the power to amend this Court's formulation by substituting "would" for "might", or by adding a second and additional requirement of a showing that the omission, in probability, affected the actual result of the vote. Neither amendment would comport with the careful craftsmanship of Mr. Justice Harlan's opinion, for a unanimous Court, in *Mills.* He used the sign "cf." to signal the difference between his announced test, using "might", and the lower court decisions and secondary authorities which had stated the test in terms of "would". 396 U.S. 384 n. 6. The word choice was deliberate and

purposeful, not inadvertent.[1] Mr. Justice Blackmun, writing for the Court in *Ute,* 406 U.S. 128, 154, followed this formulation and employed the same words to state the test of materiality, reversing the Tenth Circuit which had held that disclosure of the omitted facts was not required. 431 F.2d, at 1347.

This deliberate choice of words cannot be disregarded by the lower courts as mere dictum.[2] The Court in *Mills* was addressing the question before it: what must be established in order to complete a case of liability for misleading proxy solicitation. Materiality is an essential element of the cause of action, and the definition was an essential predicate of this Court's judgment, reversing the Seventh Circuit and directing the entry of summary judgment for plaintiffs on the issue of liability.

The Court chose in its discretion not to review the factual basis for the lower court's finding of materiality, to scour the record to assess the sufficiency of the evidence to establish the truth of the omitted facts. 396 U.S., 381 n.4. But the question of law, of the proper test of

[1] The court in *Smallwood* v. *Pearl Brewing Co.,* 489 F.2d 579, 604 (5 Cir. 1974), cert. denied 419 U.S. 873 (1974), heavily relied upon by Petitioners' Brief, 25, appears to impute this Court's deliberate choice of words to mere carelessness. A more charitable reading of that opinion would suggest that the Court meant only that the difference was insignificant, and use of either would be harmless error. *Cf. Cohen* v. *Franchard,* 478 F.2d 115, 124 (2 Cir. 1973).

[2] It is apparently on this erroneous ground of *dictum* that the Second Circuit felt at at liberty to reject *Mills* and to rule that "the 'might have been' standard mentioned by Mr. Justice Harlan sets somewhat too low a threshold. . . ." *Gerstle* v. *Gamble-Skogmo,* 478 F.2d 1281, 1302 (2 Cir. 1973).

materiality and of the "conclusion it embodies" (396 U.S., 384), was indispensable to the ultimate judgment, "that petitioners have established their case by showing that proxies necessary to approval of the merger were obtained by means of a materially misleading proxy solicitation. . . ." 396 U.S., 386.

In sum, the decision enumerates the elements of the case and provides an equation: liability is established when "proxies necessary to approval were obtained by means of a proxy" involving a "misstatement or omission . . . of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote." 396 U.S., 384. This minimum is sufficient; no more is required to be established.

The Court has recently reaffirmed the authority of the *Mills* decision as a complete and self-contained enumeration and definition of the elements necessary to establish liability:

> "There we held that complaining shareholders had proven their case under §14(a) of the 1934 Act by showing that misleading statements in a proxy solicitation were material and that the solicitation itself 'was an essential link in the accomplishment of' a merger. We concluded that any stricter standard would frustrate private enforcement of the proxy rules. . . ." *Rondeau* v. *Mosinee Paper Corp.,* U.S [45 L Ed 2d 12, 24] (1975).

In the teeth of these decisions, it is insupportable to assert that "this Court has not heretofore considered directly a standard or definition of materiality under the securities laws" or that the "Seventh Circuit adopted [a] new 'might' test". Pet.Br. 17. It is petitioners, not

the Seventh Circuit, who have failed to heed the authority of this Court's decisions.

2. The Basic Issue of Materiality, However the Test May be Phrased, Is Whether the Matter Is Important Enough, in Light of the Legislative Purpose, that Shareholders Ought to be Informed.

The difference between "might" and "would", in asking whether a fact carries importance in the consideration of the reasonable shareholder, may be called "gossamer", as both the Second and Seventh Circuit (in supposed conflict warranting certiorari) have noted.[1] Petitioners have commendably withdrawn from that grammarian conflict in their brief on the merits, advancing a test that uses neither the future perfect nor the future perfect conditional form of the verb, but says simply that materiality means "such information *as is* important to the reasonable investor . . . ." Pet. Br. 16 (emphasis added).

The lower courts have frequently concluded that the choice between "might" and "would" is indifferent to the outcome of a concrete case; the same result is reached with either word.[2] Other courts have demonstrated the insignificance of the choice by using the terms interchangeably, without mention of any possible difference.[3] Even

[1] Opinion below, 512 F.2d 324, 331 n. 13; *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1302 (2 Cir. 1974).

[2] See, *e.g.*, *Ash* v. *Baker*, 392 F.Supp. 368, 371-72 (E.D. Pa. 1975); *Lewis* v. *Marine Midland Grace Trust Co.*, 63 F.R.D. 39, 43 (S.D.N.Y. 1973); *Harnett* v. *Ryan Homes, Inc.*, 496 F.2d 832, 838 (3 Cir. 1974) (cited in Petitioners' Brief 26 for the "would" test). See also *Broder* v. *Dane*, 384 F.Supp. 1312,1320-21 (S.D.N.Y. 1974) (doubting whether "a verbal formula is useful").

[3] See, *e.g.*, *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 363, 374 (2 Cir. 1973), cert. denied 414 U.S. 910 (1973).

in the Circuits where the Courts of Appeals have consciously chosen to reject *Mills* and *Ute* and to employ "would", subsequent opinions have ignored the distinction and followed the "might" language dictated by this Court.[1]

The precise phrasing of the definition of materiality need not be graven in stone. In the flexibility of language, a variety of formulations have been used without difficulty by the courts to express the basically simple idea.[2] Respondent has no quarrel with "might", "would", or petitioners' "as is", since under any possible definition within the realm of reason, the omitted facts in this case are plainly material.

What is vital, however, beyond any niceties of phrasing, is the necessity for a keen awareness of the fact that the definition of materiality is purposeful, not an empty dictionary exercise. The test, however phrased, must be applied to achieve the underlying statutory purpose: to give investors the information, fully and fairly, which they ought to have in order to reach in-

[1] After *Gerstle*, using "would", the same Circuit adhered to "might" in *Sonesta Int'l. Hotel Corp.* v. *Wellington Associates*, 483 F.2d 247, 252 (2 Cir. 1973); *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith*, 495 F.2d 228, 239 (2 Cir. 1974); *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 381 (2 Cir. 1974). After *Smallwood*, using "would", the same Circuit adhered to "might" in ~~*Simon v. Merrill Lynch, Pierce, Fenner & Smith*, 482 F.2d 880 (5 Cir. 1973)~~; ~~and~~ *Sargent* v. *Genesco*, 492 F.2d 750 (5 Cir. 1974).

[2] See, *e.g.*, *Kohler* v. *Kohler Co.*, 319 F.2d 634, 642 (7 Cir. 1963) (facts are material which in reasonable and objective contemplation might affect the value of the corporation's stock); *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 362-63 (2 Cir. 1973), cert. denied 414 U.S. 910 (1973) (using the concept of "weightiness" as the test of materiality).

telligent, informed, and well-advised decisions. To keep the legislative purpose in the forefront, a more effective definition has been adopted by the SEC, committed to that purpose: "material" information means "matters as to which an average prudent investor ought reasonably to be informed before making his decision." Rule 405(1), 17 CFR §230.405(1) (under the 1933 Act).

3. This Court in Mills Rejected the Probability of a Different Vote as a Test of Materiality or Liability under the Proxy Rules.

Petitioners apparently charge the Seventh Circuit with error in failing to add to the test of materiality a requirement of proof of a "real probability [that] an omitted fact would affect a voting (or investment) decision." Pet. Br. 25 n. 17. In this position, they are asking, albeit guardedly, nothing less than the overruling of *Mills*, where the Court expressly rejected any such requirement.

The argument was more openly presented by the original petition, where they avowedly sought "a trial on the issue of materiality" requiring a finding "that the omission or misstatement is likely to alter the outcome of shareholder voting." Pet. 16, 13. In their brief on the merits, the argument is made only inferentially, that a trial must be held to determine whether the TSC shareholders would still have approved the merger if the proxy statement had been truthful.

Petitioners' argument here runs along this line: Because probability has been eliminated as an element of causation by *Mills*, that same probability should be reintroduced as an element of materiality. Pet. Br. 16-17, 24-25 n. 17. This striking non-sequitur would impute to the Court in *Mills* a plot to take with the left what it

gave with the right. It would play a game of labels, requiring proof of a "real probability" of an opposite outcome of the vote under the label of materiality rather than causation. Under this view, the decision in *Mills* was no more than a verbal trick.

The *Mills* decision will not support such a vacuous interpretation. The sentence immediately following the paragraph defining "this requirement" of materiality proceeds: "There is no need to supplement this requirement, as did the Court of Appeals with a requirement of proof of whether the defect actually had a decisive effect on the voting." 396 U.S. 384. Recognizing "the impracticalities of determining how many votes were affected", this Court concluded that "reliance by thousands of individuals, as here, can scarcely be inquired into . . . ." 396 U.S. 385, 380. Whether under the label of materiality, causation, or reliance, *Mills* stands as irrefutable authority against any requirement of a showing that the vote was in fact affected by the defect in the proxy statement.

Eschewing a direct adjudication of that issue, the Court of Appeals in *Mills* had fallen back to an objective approach to the effect on the outcome of the vote, looking not to actualities but to the "probabilities that the merger would have received a sufficient vote even if the proxy statement had not been misleading." 396 U.S., 380. The denial of summary judgment without a finding of those "probabilities" was the precise issue presented to this Court in *Mills*, and the reversal directly rejected any requirement of such a probability. Here petitioners are offering, at most, that same rejected claim in a slightly altered guise, insisting that there must be a finding of "a real probability" or "a strong likelihood" of the defect "to affect the shareholder/investor's decisions" and

to lead "'a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course.'" Pet. Br. 24, 25, 27.

Even assuming that petitioners here refer to a hypothetical reasonable shareholder, rather than to the actual shareholders who voted, they are simply repeating, in different words, the position directly rejected in *Mills*: that the effect must be such as to make it probable that the reasonable shareholder would have changed his vote, taking into account the other information supplied including the attractiveness and fairness of the offer. There is no requirement that the nondisclosure must be determinative of the reasonable shareholder's vote. Describing the lower court's decision in *Mills*, this Court observed:

> "Thus, the failure to make such a disclosure was found to be a material defect 'as a matter of law,' thwarting the informed decision at which the statute aims, *regardless of whether the terms of the merger were such that a reasonable stockholder would have approved the transaction* after more careful analysis." 396 U.S., 384 n. 6. (Emphasis added)

Congress has not confined the shareholders to the rights that would be claimed by a rational, purely economic man. "There is no justification for presuming that the shareholders of every corporation are willing to accept any and every fair merger offer put before them." 396 U.S., 382 n. 5. On the contrary, they are guaranteed the right to weigh "the many other factors that might lead shareholders to prefer their current position to that of owners of a larger, combined enterprise. . . ." 396 U.S., 382. n. 5. To rule that a nondisclosure is not material when it is "too insignificant" (Pet. Br. 25 n.

17) to alter the reasonable shareholder's vote "would allow the stockholders to be bypassed . . . . A judicial appraisal of the merger's merits could be substituted for the actual and informed vote of the stockholders." 396 U.S., 381.

In short, the reasons which led this Court in *Mills* to reject proof of probability of an effect on the outcome of the vote as a prerequisite to liability were not confined to any question of causation. They are rooted in the legislative purpose, and apply as well to the same proof of probability advanced as a test of materiality.

4. Under Mills, Propensity to Affect the Voting Process Is Inherent in the Conclusion that a Reasonable Shareholder Might Consider the Omitted Fact to Be Important.

The Court in *Mills* did not contradict itself, and require a finding of a probable change in outcome of the vote, directly or indirectly, by using the phrase "significant propensity to affect the voting process." That phrase, which forms the foundation for petitioners' whole argument on materiality, does not lay down a conflicting, supplemental, or different standard. It is rather a characterization of the inherent tendency or inclination implicit in the test of materiality which immediately precedes it. In context, the opinion states that materiality

> "embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote. This requirement that the defect have a significant *propensity* to affect the voting process is found in the express terms of Rule 14a-9, and it adequately serves the purpose of ensuring that a cause of action cannot be established by proof of a defect so trivial, or so unrelated to

> the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by § 14(a)." 396 U.S. 384

This passage was directly addressed to the issue before the Court: What effect on the voting process must be shown to establish liability for omissions or misstatements in a proxy statement? The answer is plain. The "significant propensity" is established when the defect "might have been considered important by a reasonable shareholder." No further inquiry is required into the probability of a different outcome of the voting process. The requisite propensity inheres in the conclusion that the nondisclosure might reasonably have been considered important. For this obvious reason, this Court in *Ute*, 406 U.S., 154, made no mention of propensity at all.

5. The Opinion of the Court of Appeals Properly Applies the Holding of Mills.

Fairly read, the opinion of the Court of Appeals in this case does no more than restate these principles. The author of that opinion had served as a member of the panel of the Seventh Circuit which had been reversed in *Mills* for ordering a trial of the probabilities that the defect affected the voting process. Once burned, twice shy, the writer was reacting adversely to the same arguments which had brought reversal before. He was rejecting the claim that trial must be held with "a finding of some probability that the omitted fact would affect the voting process" because of the difficulty of proof. 512 F.2d, 331. He was rejecting not the significant propensity which inheres in the conclusion that the defect might have been considered important by a reasonable shareholder, but rather a distorted and discredited "propensity" converted to a "probability", which would require "some evidence, direct or indirect, tending to show that the challenged omission had an actual impact in his case." 512 F.2d 331 n. 13.

For the same reasons, the Court of Appeals was leery of any "would" test of materiality as implying the need for a trial, and in common sense saw no difference "in the trial context, between proofs which show that a particular omission would have been relied on, and those which show that the omission was in fact relied on . . . ." 512 F.2d, 331 n. 13. It was *not* saying that no "significant propensity" is required, but rather correctly "recognized that the concept of materiality is itself defined in terms of potential causative effects" (512 F.2d, 329), and was adhering to this Court's direction that no showing of propensity can be required beyond the propensity inherent in the conclusion that a reasonable shareholder might have considered the nondisclosure to be important.

Thus the words "propensity", "might", or "would" do not describe a factual burden of proving what would or did actually happen. The question to be decided is the logical force of the information within the processes of ordinary reason common to average, prudent investors.

The Court of Appeals thus correctly concluded, in obedience to this Court's command, that materiality must be measured not along the scale of degrees of factual probability, but along the scale of degrees of relevancy or logical weight. Thus "relevancy alone is the critical test of materiality" without proof of probable reliance or causation. 512 F.2d, 331 n.13. Along this scale of relevancy, it is necessary that the omitted fact is of such a character as to be *important* to the *reasonable*

shareholder, not trivial or unrelated to the transaction, as the opinion below correctly recognizes and emphasizes. 512 F.2d, 331, 332, Pet. A. 9-12.

The opinion rules that nondisclosure of the extraordinary fact that only a minority of the TSC board voted for the transaction was not "*clearly* relevant" (emphasis added), and was not therefore material as a matter of law. 512 F.2d, 338. While respondent believes that the fact was of such a character as to be of considerable importance to the reasonable shareholder, urged on by the ostensible advice of his board, and that the Court of Appeals erred in this restrictive ruling, the decision on this point plainly refutes any notion that the lower court was adopting some flat, Draconian rule under which any barely relevant fact would have to be included.[1] Pet.Br. 23. Any possible implication to the contrary that might be drawn from the concluding sentence of footnote 13, 512 F.2d, 331, is foreclosed by this ruling. In any event, this Court does not sit to reverse lower court footnotes.

The Court of Appeals in this case made a scrupulous effort to abide by this Court's teachings. It reached the right result, and entered the proper judgment. If some language in the opinion were thought to be overbroad, that verbal fault would not justify reversal, and could be readily corrected by this Court's opinion.

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[1] The first Question Presented, Pet. Br. 3, is not an accurate characterization of the opinion below in this respect. It is also inaccurate in stating that the Seventh Circuit held that "possible importance to 'some few stockholders'" would suffice. The court below was rather speaking of facts which would be "determinative" for some few stockholders, although not for all. 512 F.2d, 330.

If, moreover, some new and different test of materiality were now to be announced by this Court, as petitioners contend, this Court is as well situated as the Court of Appeals to apply such a test to the uncontroverted facts. To reverse for reconsideration in light of such a new, refined, or altered test of materiality, visiting the costs of this appeal upon respondent would be a step backward from the salutary principle of *Mills* that the expenses of litigation in the corporation's behalf establishing a violation of the securities laws should be shared by that corporation and its shareholders. 396 U.S., 389-395.

6. Petitioners' Violations Were Properly Adjudicated as a Matter of Law, and Summary Judgment Was Correctly Entered by the Court of Appeals.

Once it is plainly understood that materiality under *Mills* involves no issue of factual probability of any actual past or future occurrence, the question whether a reasonable shareholder might have considered the omitted fact to be important is revealed as only a useful metaphor employing a hypothetical person in an abstract situation, knowing what had been concealed. The issue is not prediction, but whether, in light of the underlying statutory purpose, the shareholder ought to be informed before casting his vote.

When the omission is established by the content of the proxy statement, and the external facts not disclosed are conclusively established by documentary evidence, there remains no issue of fact to be litigated. In this case, the resolution of whether a violation has been established turns upon the interpretation of the governing statute and rules, construed in the light of the regulatory scheme as a whole, the interrelationships among its

various regulations, the legislative history, and the guidance provided by judicial precedent and by authoritative interpretations by the administrative body with expertise and responsibility in the area.

Whether the law imposes a duty of disclosure under these admitted circumstances, that is, the question of materiality, is thus a matter of law. It is a question of what the law requires, for the judge to decide, not a question of fact to be resolved upon evidence at a trial with a jury or judge as trier of fact. A determination of materiality in this case does not involve "findings of fact" but rather "application of legal standards"[1] a question of law. Cf. *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 364 (2d Cir. 1973), cert. denied 414 U.S. 910 (1973).

Upon any reasonable standard of materiality this case was clearly appropriate for summary judgment on the issue of liability. Such judgments are commonplace.[1] This Court's decision in Mills itself refutes any notion that summary judgment could never be granted in plaintiff's favor, based on a ruling that the proxy statement violates the proxy rules as a matter of law. This Court specifically directed the entry of such a judgment. 396 U.S., 383. There was certainly no "misuse" of summary judgment to petitioners' prejudice. Pet.Br. 3.

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[1] Plaintiffs' summary judgments were granted or affirmed, by way of example, in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1972), and *John Hopkins University* v. *Hutton*, 422 F.2d 1124 (4th Cir. 1970), both relied upon in Petitioners' Brief, as well as in *Beatty* v. *Bright*, 318 F.Supp. 169 (S.D. Iowa 1970), *Berman* v. *Thomson*, 312 F.Supp. 1031 (N.D. Ill. 1970), and *Gould* v. *American Hawaiian S.S. Co.*, 331 S.Supp. 981 (D. Del. 1971) all cited and relied on in the District Court's denial of summary judgment here. 361 F.Supp. 112, Pet. A. 34-35.

The facts omitted from the joint proxy statement at bar are not in dispute. These facts were of substantial importance to TSC stockholders in considering the proposal which they were urged to accept by their own management. Without disclosure of these facts, relating to National's control, the market prices of National's securities, and the value of the National warrants, TSC stockholders could not make an intelligent appraisal of the proposal.

CONCLUSION

Respondent asks that the decision of the Court of Appeals for the Seventh Circuit be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975.

No. 74-1471

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.), A DELAWARE CORPORATION,

Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' REPLY BRIEF.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975.

No. 74-1471.

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.), A DELAWARE CORPORATION,

Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

I.

THE OMISSIONS COMPLAINED OF DID NOT MAKE THE PROXY STATEMENT FALSE OR MISLEADING IN ANY MATERIAL RESPECT.

(Reply to Respondent's Brief pp. 6-10, 11-61, 78-81 and SEC Brief pp. 17-24.)

The critical issue in this Court is whether, within the framework of this summary judgment record and the limitations of Rule 56, F. R. Civ. P., the court below could properly find that certain omitted information was so essential to fair pre-

sentation of the required subject matter that its nondisclosure rendered the Proxy Statement itself false and misleading in violation of Rule 14a-9 of the proxy rules.

Respondent ("Northway") misses the point with its extended discussion and argument about evidentiary facts relating to the four complained of omissions. Merely establishing the relevancy of an omitted fact is not enough to bring the Proxy Statement within the proscription of Rule 14a-9 on this summary judgment record. Much more is needed: Northway must show that, beyond factual dispute, an omitted fact was necessary to fair presentation of the subject matter and that leaving it out rendered the Proxy Statement false or misleading in a material respect.

All of the information specified in Schedule 14A, Item 14, of the SEC's proxy rules was disclosed.[1]

Rule 14a-9 by its terms[2] is violated only when (1) the omitted fact itself is material *and* (2) its omission makes the disclosures of the proxy statement itself (as a matter of law on this summary judgment record) false and misleading in a material respect.[3] There are no such violations here.

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1. Neither the District Court nor the Seventh Circuit found Northway was entitled to summary judgment for violation of Rule 14a-3. 361 F. Supp. at 111; 512 F. 2d at 329.

2. Rule 14a-9 provides:

> "No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

3. *Crane Co.* v. *Westinghouse Air Brake Company*, 419 F. 2d 787, 799-800 (2d Cir. 1969), *cert. denied*, 400 U. S. 822 (1970). Pet. Br. pp. 27-29.

A. Restatement of the Decisive Facts.

Brief recitation of the decisive facts shows that the allegedly material omissions on which Northway built its case do not even *remotely* qualify as violations of Rule 14a-9. The complained of omissions are minor and subsidiary facts. They are not, as required by the Rule, important, consequential or dramatic and their omission does not operate to create a false impression as to essential characteristics of the transaction.

The original complaint in this action was filed on December 4, 1969, the day before the stockholders' meeting. It alleged a conspiracy between National and the National-controlled directors of TSC to cheat the general body of shareholders of TSC by agreeing to an unfair deal which would give the TSC shareholders far less for their stock than it was worth.

Obviously because of a lack of sufficient evidence to prove these allegations, Northway did not seek interim relief to prevent consummation of the transaction. Instead, it allowed the transaction to close and watched while post-closing changes in the business progressed and trading went on in the securities for years.

Subsequent intensive discovery by Northway failed to develop evidence to support the allegations that the TSC shareholders were cheated and Northway makes no pretense to the contrary. Absent any such evidence, Northway effectively abandoned its fraud allegations and, in July 1972, moved for partial summary judgment on the theory that certain omissions of minor facts (1) concerning the possibility of National's influencing the decisions of TSC and (2) allegedly touching on the market prices of National's securities made the Proxy Statement so misleading that, had they been disclosed, the shareholders might have refused to approve the transaction because they might have suspected that they were being cheated. Northway thus sought to achieve by indirection (successfully in the Seventh Circuit) what it could not achieve on the merits, be-

cause proof of the substantive allegations of fraud could not be found.

The reason that such proof could not be found is plain. As discussed in our principal Brief at pp. 13-14, 35, the record, even in its present incomplete form, establishes plainly that the essential terms of the transaction were not dictated by National, but were determined by an independent investment banker on the board of TSC.

It was Mr. Noyes, a member of the investment banking firm of Hornblower & Weeks-Hemphill, Noyes ("Hornblower"), who proposed the terms of the transaction which National accepted without argument, discussion or attempts to negotiate.[4] Mr. Noyes and his firm had no connection with National. His firm had recently underwritten a public offering of 195,000 shares of TSC common stock and he himself was a holder of both preferred and common stock of TSC, and his wife was also a holder of common stock (A. 267).

It was Mr. Noyes and three other TSC directors not connected with National who voted TSC's approval of the transaction (A. 414). The three National directors present at the meeting did not vote although they stated they were in accord with the proposal, expressly excusing themselves on advice of counsel, as did one other non-National TSC director.

Northway vigorously complained in the courts below (and reiterated the same argument here (Br. p. 5)) that since only the four disinterested directors out of a total board of ten directors voted and four directors who were present abstained, there was not proper authorization of the transaction under Delaware law. The District Judge rejected this contention and the Court of Appeals held that Northway failed to establish

4. Despite this clear record, the SEC Brief (p. 6) blandly asserts that "National formulated a proposed merger of TSC into National . . ." and "The TSC board of directors apparently approved the proposal. . . ." Wholly ignored is the fact that Noyes rejected a previous National proposal as not sufficiently favorable for TSC's shareholders. See pp. 29-31 Petitioners' Brief.

materiality of the method of director voting.[5] Terms of the transaction were determined at arm's length and not under National's influence.

This is the context in which the four alleged omissions in the Proxy Statement must be viewed. Northway's extensive arguments relating to these omissions are discussed herein as Points II (pp. 14-22), III (pp. 23-32) and IV (pp. 33-36). Review of a few key facts points up the true insignificance of these four omissions.

1. The fact that Mr. Noyes determined the terms of this particular transaction would seem to remove any possible significance from the alleged omissions of facts touching on the possibility which National generally might have had of influencing other kinds of TSC decisions. With respect to this transaction, it is plain the terms of the exchange were not subject to any such influence.[6]

Furthermore, the omissions relied upon by Northway were of facts obviously of subsidiary significance to the disclosures prominently made in the Proxy Statement that (i) National had a 34% interest in TSC, (ii) no other shareholder had more than a 10% interest in TSC and (iii) National's five nominees on TSC's ten-man board of directors were plainly identified by name and the positions they each held in National.

The specific omissions alleged by Northway are that (1) the Proxy Statement did not disclose the titles of two of the National nominees on the TSC board—as chairman of the board and chairman of the board's executive committee, respectively, and (2) did not refer to prior filings with the SEC stating

5. 361 F. Supp. at 114-115; 512 F. 2d at 338.

6. It is astonishing that the Court of Appeals said that National sat on both sides of the table in setting the terms of the exchange. 512 F. 2d at 333. Compare Petitioners' principal Brief pp. 29-31. Equally surprising is SEC's comment on the "purported objectivity" of the TSC board (SEC Br. p. 23) in recommending the transaction to the TSC shareholders. Neither the court below nor SEC's lawyers were inhibited by Rule 56(c).

that National may be deemed to be a "parent" of TSC—*i.e.*, a parent in control of TSC.

These omissions have no relevance to the issue before this Court, namely, whether the Proxy Statement disguised improper influence which may have been exercised by National *in connection with this particular transaction*. The terms were formulated by an independent director of great financial experience who was not connected in any way with National, and approved unanimously by disinterested directors also not connected with National. The record shows that National and its representatives on the TSC board did not even attempt to influence the terms of the transaction and accepted the counterproposal of Mr. Noyes without argument.

The courts below expressly refused to find National in control of TSC on the basis of this summary judgment record. Accordingly, for purposes of this motion, National must be assumed *not* to be in control of TSC.

Furthermore, under the circumstances here, the filings indicating the possibility of control are of no significance since the control, if it existed, was plainly not exercised for purposes of the transaction in question. The concept of control is multifaceted. Control for one purpose (such as the need to comply with the registration requirements of the 1933 Act) is not control for every purpose. Thus, for example, a power to veto a transaction which this Court held to constitute control in *Rochester Telephone Corp.* v. *United States*, 307 U. S. 125 (1939), would not, obviously, constitute control for purposes of affirmatively dictating the terms of a merger.

Northway's apparent efforts to build these minor omissions into a case of concealment of control are plainly unavailing.

2. Northway also alleges that the shareholders were misled in two respects as to the value of the National securities to be exchanged for TSC stock.

Northway says, in effect, that the Proxy Statement, by reference to one of the bases for Hornblower's favorable opinion,

promised the TSC shareholders a "substantial premium" in the form of the current market prices of the National securities to be received by them. It contends that the premium which was, in fact, received was less than substantial. We deal with the intricacies of this argument, to which Northway devotes substantial effort, below in Point III (pp. 23-32).

One fact which Northway carefully ignores stands out clearly. The transaction was, in fact, received by the market as providing a substantial premium to the TSC shareholders.

Mr. Noyes testified that the October 16, 1969 recommendation made by Hornblower was based on early October market values (before public announcement of the proposal) of 16 for National preferred, and 11⅝ and 11 for TSC common and preferred, respectively. He explained that once the terms of the exchange were announced, the market prices of the TSC shares moved up. The Proxy Statement which was dated November 12, 1969, several weeks later, contained the market quotations for November 7, 1969, showing the common stock of TSC had risen in the market from 11⅝ to 13¼ and that the preferred had risen from 11 to 12, while the National preferred stock remained about the same—16⅝.

Clearly the market confirmed the correctness of Hornblower's view that the package of National securities would give TSC shareholders a substantial premium over the then current market value of their TSC securities. The amount of that premium must, of course, be calculated on the basis of the market prices before the announcement of the transaction was made and not after the market has had an opportunity to discount the premium.[7]

Northway also argues that the market price for the common stock of National may have been affected by insufficiently disclosed market purchases of National and/or undisclosed pur-

7. Thus, for example, if a tender offer is made to buy stock from the public for $30 when the market is $25, and then the market reacts and the price goes to $29, it is not fair to say that the offer of $30 is merely $1 above the market price.

chases by an unaffiliated mutual fund with some related personnel.

The common stock of National was not involved in the transaction; instead the package of securities for the TSC shareholders was principally National Series B preferred stock with some National warrants. The court below did not find that there was evidence establishing, for purposes of the summary judgment motion, that the purchases of the mutual fund were coordinated with National.[8]

Plainly lacking is any evidence establishing the effect, if any, these purchases may have had on the market price of National's common stock, which was declining during 1969. Wholly absent is any evidence of the effect of the market price of the common on the market price of the National warrants, which were to be issued in that transaction.

In such circumstances, Rule 14a-9 does not require disclosure of such purchases to enable stockholders to speculate as to the possible remote effect of such market transactions on the fairness of the transaction which was, as discussed above, independently arrived at and approved at arm's length.

B. The Appropriate Standard Under Rule 14a-9.

The legislative history of Section 14 of the 1934 Act (outlined at pp. 18-24 Petitioners' Brief) makes it perfectly clear that, for Rule 14a-9 to be violated, it must be shown that the absence of the omitted fact so seriously distorted the factual disclosures actually made in the proxy statement as to give shareholders a false impression as to the basic nature of the matters on which they are being called upon to vote. Omissions of minor matters, even those whose disclosure might seem desirable, are not intended to be reached by the Rule. Rule 14a-9 is basically structured to prevent major omissions which result in fraud, not to

8. 512 F. 2d at 336: "While we agree that collusion is not conclusively established by the omitted facts, it is certainly suggested."

impose liability for the omission of matters of minor or subsidiary importance whose disclosure is not specifically required by the SEC's rules.

Rule 14a-9 is derived from similar provisions in the Securities Act of 1933 dealing with false and misleading statements in registration statements. See Sections 11, 12(2) and 17 of the 1933 Act. To a significant extent those antifraud provisions of the 1933 Act were based upon the prior English experience and precedents, particularly the well-known and then current decision in the *King* v. *Kylsant* (Lord), [1932] 1 K. B. 442 (1931). Houston Thompson, who was one of the authors of the 1933 Act and a former member of the Federal Trade Commission, testified that:

> "Now, in the preparation of this bill we had a number of proposals so far as legislation is concerned before us. We had the British act before us. We had this case of Lord Kelsant before us—the *King* v. *Kelsant*—which arose under the British act; and, if you recall, several months ago Lord Kelsant was sent to prison for violation of the act. It is rather interesting to note that he was sent to prison for failing to give the information that he should give; in other words, for concealing information." Hearings on H. R. 4314 before the Committee on Interstate and Foreign Commerce, 73rd Cong., 1st Sess. 11 (1933).

Kylsant is a classic example of an omission which makes the related statement actually made false and misleading in a material respect. Lord Kylsant was chairman of a shipping company which issued a prospectus relating to the issue of 5% debenture stocks. The prospectus stated that the "audited accounts of the company show that during the past ten years the average annual balance available . . . has been sufficient to pay the interest on the present issue more than five times over." The prospectus also contained a table showing that the company paid dividends every year since 1911 but one.

Those statements in the prospectus were literally true as far as they went; however, they were made seriously deceptive by

the failure of the prospectus to state that although the company had made "very large profits in 1918, 1919 and 1920", in the years 1921-27 substantial trading losses were suffered. Accordingly, during the six years prior to the offering, the company did not have sufficient current income available to meet the interest on the debentures or for the payment of dividends.

The British court held the prospectus was "false in a material particular in that it conveyed a false impression," and stated (at p. 448):

> "The falsehood in this case consisted in putting before intending investors, as material on which they could exercise their judgment as to the position of the company figures which apparently disclosed the existing position, but in fact hid it."[9]

The SEC appreciated the importance of *Kylsant* in the evolution of the 1933 Act and cited *Kylsant* in its first decision on the question of whether an omission in a registration statement makes it materially false and misleading. *In the Matter of Charles A. Howard*, 1 S. E. C. 6 (1934), the SEC observed:

> ". . . the half-truth embodied in the registrant's answer [to an item in the registration statement] is the very type of untruth to which the language of the Securities Act relating to omissions of material fact has reference. In the language of Mr. Justice Avory, the registrant's statement is 'false in

9. The legislative history of the 1933 Act also clearly demonstrates the express Congressional concern to assure that a "mere omission" will not be the basis for liability, but that liability could be imposed only where the omission makes the registration statement itself misleading. The Conference Report, H. R. Rep. No. 152, 73rd Cong., 1st Sess. 26 (1933), notes that the House Bill "made the liability depend upon the making of untrue statements or omissions to state material facts." It says that "[t]his phrase has been clarified in the substitute to make the omission relate to the statements made in order that these statements shall not be misleading, rather than making the mere omission . . . a ground for liability where no circumstances exist to make the omission in itself misleading."

> a material particular in that it conveyed a false impression.' *Rex* v. *Kylsant* [1932] 1 K.B. 442, 448."[10] 1 S.E.C. at 11.

Both the language used and the regulatory purpose of Section 14(a) of the 1934 Act[11] make it clear that Rule 14a-9 calls only for information whose absence, in *"the light of the circumstances"* and in the context of the entire proxy statement read fairly, so distorts the disclosures actually made[12] as to make such disclosures themselves false and misleading in some important respect.

Kylsant and the related SEC decision in *Howard* accurately reflect the legislative purpose and thus constitute a yardstick against which allegations that an omission constitutes a violation of SEC Rule 14a-9 must be measured.[13]

10. Judge McLean in *Escott* v. *BarChris Constr. Corp.*, 283 F. Supp. 643, 681 (S. D. N. Y. 1968), commented that the definition of materiality stated in *In the Matter of Charles A. Howard* "is still valid today."

11. Developed at pp. 18-24 of Petitioners' Brief; also see remarks of Congressman Mapes of Michigan who explained the object of the legislation by referring directly to the strong dissent of Justice Stone in *Rogers* v. *Guaranty Trust Co.*, 288 U. S. 123, at 138-139, 141-142 (1933), where American Tobacco Company shareholders were hoodwinked into approving excessive stock options for management through a deceptive proxy solicitation. 78 Cong. Rec. 7822-23 (1934) (remarks of Rep. Mapes).

12. A distortion which frustrates the free exercise of shareholders' voting rights because they are not given an explanation as to "the real nature of the questions" for which authority to cast his vote is sought. *J. I. Case Co.* v. *Borak*, 377 U. S. 426 at 431 (1964). To the same effect see SEC Exchange Act Release No. 1350 (August 13, 1937), entitled "Statement by Commission with respect to the purpose of the disclosure requirements of Section 14 and the rules adopted thereunder," which stated:

> "The purpose of these rules is to prevent the dissemination to the security holders and to the general public of untruths, half-truths, and otherwise misleading information which would stand in the way of a fair appraisal of a plan upon its merits by the security holders."

13. This yardstick is consistently applied in determining materiality in the three major post-1934 materiality cases, *Texas Gulf Sulphur*, *Cady Roberts* and *Merrill Lynch* (cited and described in Pet. Br. pp. 26-27 and n. 21), each of which dealt with concealment

Recent decisions of this Court involved the concealment or omission of truly important facts. In *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, *reh. denied*, 407 U. S. 916, 408 U. S. 931 (1972), bank officials, under circumstances where there was a duty to disclose, purchased securities without advising the seller that the prevailing market price was *far in excess* of the purchase price paid by the bank or that they were dual agents. And *Mills* involved, in this Court's own words, a "failure to reveal [in a merger proxy statement] a serious conflict of interest on the part of the directors . . . thwarting the informed decision at which the statute aims."[14]

An extension of Rule 14a-9 to create liability for omissions which do not have any major impact on the matter to be voted on by shareholders would be clearly inconsistent with the purpose and intent of the Rule. Absent a clear focus on the real-life importance of the omission, the courthouse doors are wide open to claims based on nothing more than the ingenuity and imagination of counsel, combing through proxy statements with the benefit of 20-20 hindsight, and second-guessing the good faith judgments made by the issuer and its counsel in the preparation of proxy statements.[15] The omitted information, to give rise to liability under Rule 14a-9, must be of such obvious consequence that its omission is outside of the range of permissible judgments. Paraphrasing a statement Judge Weinfeld made in a recent tender offer case,[16] unless there is a " 'reasonable area of discretion . . . in deciding what facts need to be disclosed' ", proxy statements would "become something akin

or misuse of information which was of undoubted and dramatic significance to investors.

14. *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 at 384 n. 6 (1970).

15. Policy issue here raised parallels the policy questions analyzed by this Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723 at 737-749 (1975).

16. *Spielman* v. *General Host Corp.*, 402 F. Supp. 190, 203 (S. D. N. Y. 1975), quoting in part from *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F. 2d 341, 369 (2d Cir. 1973), *cert. denied*, 414 U. S. 910 (1973).

to walking across a minefield in which the slightest misstep means substantial liability" for the issuer.

Plainly the standard used must focus on the importance of the omission to the matter being submitted to the shareholders for their approval and the overall "false impression" generated by the omission rather than on the particular verbiage used to articulate the test of materiality. This is amply demonstrated by the SEC's Brief. The SEC accepts the "significant propensity test" as articulated in *Mills* and presumably rejects the broader test adopted by the Seventh Circuit. (SEC Br. pp. 9, 13, 15) Yet, at the same time, it concludes that the alleged omissions caused the Proxy Statement to violate Rule 14a-9.[17]

While Petitioners have regarded the "significant propensity" test as an appropriate statement for the rule of materiality, implying as it appears to do the importance of the facts omitted, the misreading of that standard by the SEC, with all its prestige in the field, shows there is need for this Court to use clearer and stronger language so as to emphasize that only the omission of facts of critical and vital consequence to shareholders' decision renders a proxy statement misleading.[18] We have no formulation which we can urge on the Court to carry conviction to the SEC and the plaintiffs' bar that minor matters are not enough. Petitioners cannot say whether the words should be *vital, critical, obviously determinative*, or whether some other stronger phrase is more appropriate to this purpose. Manifestly, it should be stated in clear and unmistakable language

17. SEC Brief pp. 4, 17-24.

18. The Seventh Circuit, in its rejection of the "significant propensity" test showed, we think, a better understanding than does the SEC's Brief of its intended meaning. The Seventh Circuit apparently felt that it was unable to accept the contentions which the SEC made in that Court that the proxy statement was materially false and misleading under that test. It therefore adopted a broader test which the SEC in its Brief now appears to reject because it may require "furnishing large quantities of trivial information." Hence the need noted above for specific guidance in language not susceptible of misunderstanding by those desiring to stretch the statute.

that a heavy burden exists and that the fact omitted, because of its obvious significance, almost certainly would have turned the shareholders' vote the other way.

II.

IN THIS COURT NATIONAL IS NOT IN CONTROL OF TSC; HENCE, CIRCUMSTANTIAL EVIDENCE ARGUED AS TENDING TO INDICATE CONTROL IS NOT MATERIAL AS A MATTER OF LAW AND CANNOT RENDER THE DISCLOSURES MADE FALSE OR MISLEADING. IN ANY EVENT, SUCH OMISSIONS ARE IMMATERIAL AND INSIGNIFICANT.

(Reply to Respondent's Brief pp. 36-39, 47-61 and SEC Brief pp. 13-15, 21-23.)

Northway persists in raising a specter of National's alleged control of TSC, despite the fact that both the District Judge[19] and the Court of Appeals,[20] found that the alleged control of National over TSC was not established in the summary judgment record.

The Seventh Circuit's analysis of the facts relating to National's alleged control of TSC involves three steps. First, the court below concedes that no finding may be made on the issue of control, stating that "control is a factual issue presently in dispute." Second, the court finds that the omitted facts are "persuasive indicators . . . [of] control." Third, the court concludes that Rule 14a-9 has been violated because the offerees are entitled to know facts which indicate "a substantial likelihood . . . [of] control."[21]

Underlying the court's analysis of this set of facts is the proposition that Rule 14a-9 requires disclosure of suggestive facts concerning control without regard as to whether there

19. 361 F. Supp. at 111-112.
20. 512 F. 2d at 329.
21. 512 F. 2d at 329, 332-333.

actually was control. This same error in analysis is clearly demonstrated in the court's discussion of alleged manipulation where the court indicated that the purpose of Rule 14a-9 is to give stockholders facts on which they can speculate:

> ". . . the purpose: of 14a-9 is to allow stockholders to draw such inferences as they see fit. . . . It was for the shareholders to determine . . . whether the activities of Madison and National actually amounted to manipulation at all." 512 F. 2d at 336.

The Seventh Circuit's position that Rule 14a-9 requires disclosure of suggestive facts without regard to the actual state of affairs represents a basic misunderstanding of the disclosure policies underlying the Rule. The defects in the court's interpretation of Rule 14a-9 can be analyzed as follows.

On one hand, the disclosure of suggestive facts is not sufficient to satisfy the obligation of full disclosure imposed by Rule 14a-9. If there are material facts which are important to investors, the Rule requires that investors be told clearly and completely about such facts. It is not sufficient to insert suggestive facts and "allow the shareholders to draw such inferences as they see fit." Thus, if the market price of National's stock was in fact manipulated, such manipulation should have been made clear in the merger proxy. The obviousness of this point can be demonstrated by hypothesizing a situation in which the manipulation was proved as a fact and an investor sued National on the ground that such manipulation was not adequately disclosed. It would be absurd to suggest that National could successfully defend on the ground that it had no obligation to make clear that manipulation existed but rather was only required to disclose facts (*i.e.*, the purchases) which suggested manipulation, with the burden of discovering such facts and drawing the correct inference therefrom being on the investor.

On the other hand, the disclosure of suggestive facts without regard to the actual state of affairs could violate the obligation imposed by Rule 14a-9 to avoid misleading statements.

If the actual state of affairs is contrary to that which the suggestive facts would seem to indicate, a company could be liable for misleading an investor. The possibility of such liability may be demonstrated by hypothesizing a situation in which it was proven that National did not control TSC and an investor sued alleging that he voted against the TSC transaction on the ground that he believed (on the basis of Yarmuth's and Simonelli's board titles and the 8-K disclosure) that National exercised control over the TSC board's recommendation. It would be absurd to suggest that National could successfully defend on the ground it was obligated under Rule 14a-9 to include facts which mislead the investor by suggesting "a substantial likelihood . . . [of] control" even though there was no control.

The analysis in the two preceding paragraphs indicates that the court's interpretation of Rule 14a-9 was erroneous. If the Seventh Circuit had applied a proper interpretation of Rule 14a-9 to the facts, it would have reached different results and found that the omissions were not misleading. As indicated above, a correct reading of the full and fair disclosure requirements of Rule 14a-9 requires full disclosure of the actual state of affairs without the inclusion of statements which could be misleading. Indeed the obligation not to mislead imposed by Rule 14a-9 indicates that there was a duty to omit facts merely suggesting manipulation or control.

A. Prior SEC Filings Were Not Significant.

(Replying to Respondent's Brief pp. 52-61 and SEC Brief pp. 21-23.)

In opposing the Petition and again in its Brief Northway has argued that control over TSC should be inferred from the February and March 1969 periodic reports to SEC made by National and TSC when the Schmidt family's control of TSC ceased upon the resignations of Charles Schmidt and his son following the sale of all of their stock to National (Resp. Br. pp.

53-61). The TSC 8-K had to be filed when Schmidt's control had ceased. National was required under Section 13 of the 1934 Act to file a Form 13-D when it acquired more than 10% (now 5%) of the voting securities of TSC. These were the obvious facts that triggered the reports and each report contained the stylized recital that National "may be deemed to be a parent of TSC."

The courts below both rejected Northway's contention, in its motion for summary judgment, that the Proxy Statement violated Rule 14a-3 in that it failed to disclose that National controlled TSC, holding that "the issue of control is a factual issue presently in dispute." 512 F. 2d at 329. Northway's contention seems to be that the "parent" statement contained in the SEC filings had to be disclosed, nevertheless, because it suggested the possibility of such control and thus might affect the independence of the TSC board's recommendation.

The Proxy Statement disclosed, as required by the proxy rules, that National owned 34% of the TSC stock, that no other shareholder owned more than 10% of the TSC stock and that five out of ten TSC directors were National nominees (A. 267-268). These required disclosures clearly indicated to the shareholders of TSC that National might have been in a position to exercise some degree of influence over TSC. The addition of the reference to the SEC filings would have done little, if anything, to add to a shareholder's awareness of National's possible influence over TSC.[22]

22. The SEC's Division of Corporate Finance which examined the Proxy Statement must, of course, have been fully aware of the prior periodic filings reciting that National "may be deemed to be a parent" of TSC, and its letter of comment dated November 10, 1969 (A. 96-100) made no suggestion that reference should be made to the fact that this statement was contained in the prior filings, which it plainly would have had it believed that such a disclosure was required or even desirable. The lower courts have consistently held that where facts are within the knowledge of the SEC, by reason of separate filings or otherwise, weight will be given to the judgment of the SEC staff not requiring their disclosure. See *e.g.*, *General Time Corporation* v. *Talley Industries*,

Furthermore, as discussed above, the terms of this particular transaction were in fact determined by Mr. Noyes, a TSC director and a partner of Hornblower, TSC's investment banker, and not by National, and were approved in that form by the unanimous vote of four independent directors with National's nominees abstaining.

Viewed in context of the prominent and plainly stated disclosures of National's equity interest in TSC and the presence of five National nominees on TSC's ten-man board (A. 267-268) and the actual absence of influence with respect to the terms of the transaction, it is idle to suggest that an explicit reference to the "may be deemed a parent" language in the prior SEC filings was so essential to fair disclosure that its omission caused the statement that the TSC board had approved and recommended the transaction to convey a false impression to the reasonable TSC shareholder.

B. The Board Titles of Yarmuth and Simonelli Were Insignificant.

(Replying to Respondent's Brief pp. 36-39, 47-50 and SEC Brief pp. 21-23.)

The Proxy Statement states that the TSC board approved the transaction and recommended its approval by the shareholders (A. 267). There is no dispute here that the TSC board took this action by the unanimous vote of only four non-National directors, and that none of National's nominees voted. The four independent directors acted on the basis of an opinion given to the board by Hornblower, an independent and competent investment banking firm. 512 F. 2d at 337.[23]

Inc., 403 F. 2d 159, 163 (2d Cir. 1968), *cert. denied*, 393 U. S. 1026 (1969); *Union Pac. R. R. Co.* v. *Chicago & N. W. Ry. Co.*, 226 F. Supp. 400, 406-407 (N. D. Ill. 1964). See also *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 432 (1964).

23. One non-National director also abstained because of his recent sale of TSC stock to National for cash and notes payable over five years.

Nonetheless, Northway contends that the disclosures of the TSC board's action and recommendation of the transaction were seriously misleading because the Proxy Statement did not disclose that Mr. Yarmuth was Chairman of the TSC board of directors and that Mr. Simonelli was Chairman of the TSC board's Executive Committee.[24] Northway argues these additional disclosures were required to show National's potential of influence over TSC.

The Proxy Statement did, of course, prominently (1) disclose that five out of the ten TSC board members were National nominees; (2) identify all members of the TSC board; and (3) specify which were the National nominees and the position which they held in National (A. 267-268). This Proxy Statement disclosure stated that "[a]t the request of National, Mr. Stanley R. Yarmuth, President and director of National, Mr. Charles F. Simonelli, Executive Vice President and a director of National were . . . elected directors of TSC." (A. 267). Particularly when viewed in the light of the lower court's failure to find National controlled TSC, the omission of the titles[25] which Messrs. Yarmuth and Simonelli held on the TSC board plainly does not make the statements made regarding the affirmative recommendation of the TSC board misleading in any respect.

The Proxy Statement revealed the presence on the TSC board of the top executives of its 34% shareholder. This was the important fact and, under all the circumstances, the shareholders' knowledge of National's position of influence at TSC could hardly have been increased to any significant extent by the addition of these titles. Even the relevance of these titles was

24. Resp. Br. pp. 39-45.

25. Yarmuth never acted as TCS's chief executive (A. 105-106); his role as its new board Chairman was plainly shown in TSC's quarterly report to shareholders in September 1969 (A. 493-496). There is no evidence the TSC Executive Committee had any part in the transaction and National's nominees, Yarmuth and Simonelli, had a minority role on the committee which was dominated by old TSC directors Noyes, Schaefer and Sharfman (A. 471-472).

diminished by the fact that on the resolutions adopted on October 16, 1969, recommending the transaction described in the Proxy Statement, all of the National nominees, including Messrs. Yarmuth and Simonelli, abstained from voting (A. 414).

Northway denigrates abstention by National's nominees, because three of the four directors who did vote were employed by TSC which Northway's lawyers suggest put them under National's domination and made them subservient to National.[26] As evidenced by Schaefer's testimony (A. 182, 196-198) and Affidavit (A. 101-102), no such domination actually existed. The relationship of each of these three directors to TSC was prominently disclosed in the Proxy Statement (A. 268). The fourth favorable vote on the resolutions was Noyes, the investment banker who proposed the terms of the transaction on behalf of TSC and whose proposal was accepted by National without any negotiation (A. 155-156, 413). It is plainly foolish (if not materially misleading) to argue that Noyes was under National's control. He negotiated the favorable exchange ratio on behalf of TSC's shareholders. It was Noyes who formulated the counter-offer which National accepted.

On this summary judgment record those four TSC directors were free of any domination by National. Their recommendation to TSC stockholders to vote in favor of the transaction was untainted by any conflict of interest.

C. Mills Facts Were Critically Different.

(Reply to Respondent's Brief pp. 50-61 and SEC Brief pp. 11-17.)

Northway argues the judgment of the court below was required by this Court's decision in *Mills*[27] because "the controlling facts in *Mills* are directly matched by the facts here."

26. Resp. Br. pp. 45-47.

27. *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970), *reversing in part*, 403 F. 2d 429 (7th Cir. 1968), *reversing*, 281 F. Supp. 826 (N. D. Ill. 1967).

(Resp. Br. p. 51). SEC chimes in, although it tinkers with the *Mills* text (SEC Br. pp. 13-15). Each argument ignores issues of material fact in this summary judgment record and thereby strays outside the principles stated in *Mills*. In *Mills*, control of the merging company was undisputed; here, control is disputed and both lower courts found it was not established. Accordingly, on the summary judgment record before this Court, National must be assumed not to have been in control of TSC.

Judge McLaren saw obvious and compelling differences between the facts disclosed in the summary judgment record before him (361 F. Supp. at 112-113) and the facts which were analyzed in some detail by the Seventh Circuit in *Mills* (403 F. 2d at 432-434). This Court regarded materiality of the proxy statement deficiencies in *Mills* as being conclusively established below.[28]

The key defect in the *Mills* proxy statement was that it stated that the board of directors of the merging company, Auto-Lite, recommended the transaction to its shareholders but failed to adequately inform them of the "relationship between the directors and the other party to the bargain." There was no disclosure in that proxy statement that seven of the eleven Auto-Lite directors were nominees of Mergenthaler (the acquiring company) and American (its parent) or that the four remaining Auto-Lite directors were kept on as window dressing by Mergenthaler, which was "the other party to the bargain."[29]

Page 2 of the *Mills* proxy statement spelled out in bold type that the board of directors of Auto-Lite believed the merger to be "fair and equitable to the shareholders of Auto-Lite." Buried on page 23 of that same proxy statement was an inadequate disclosure that four of the eleven Auto-Lite directors were also directors of Mergenthaler. Completely concealed from the Auto-Lite shareholders was the undisputed fact that Mergenthaler and American enjoyed and exercised effective day to

28. 396 U. S. at 381, n. 4.

29. 403 F. 2d at 433-434.

day, working control of Auto-Lite[30] for some time preceding the date of the proxy statement, and that seven of the eleven Auto-Lite directors were Mergenthaler nominees.

In sharp contrast to *Mills*, the Proxy Statement herein grouped together on pages 6 and 7 (A. 267-268) under bold-faced headings statements of approval of the transaction by both boards of directors, coupled with full statements of the substantial equity interest of National in TSC, National's five nominees of TSC's ten-man board of directors and the essence of the proposed transaction, all in understandable, equally prominent, direct language.[31]

National's alleged control of TSC is hotly disputed on this record. *A fortiori*, the Investment Company Act exemption National obtained in 1964 was wholly unrelated to its relationship to TSC in 1969.[32]

30. Effective working control of Auto-Lite by American through Mergenthaler was proved to the satisfaction of SEC which exempted American from provisions of the Investment Company Act of 1940 because it had and exercised such complete control.

31. The District Judge found (361 F. Supp. at 113):

> "Unlike the proxy statement dealt with in *Mills*, the joint proxy statement complained of here gives similar emphasis to the board's recommendation, National's equity interest in TSC, and the number and some of the positions of National's nominees. If the TSC shareholders were misled as to National's relationship to TSC, the circumstances under which this occurred can hardly be compared to the total concealment of the conflict of interest in *Swanson*."

32. This exemption is unrelated to TSC and National's relationships to TSC. National's Investment Company Act exemption related to companies a portion of whose securities National owned in 1964, five years before National bought Schmidt's TSC stock in 1969. By 1969, when National first acquired stock and later obtained board representation in TSC, exemption from the Investment Company Act was no longer of interest to National because the nature of National's assets had completely changed and National's investments in securities of other companies had fallen far below the 40% benchmark found in the "investment company" definition.

III.

OMISSION OF REFERENCE TO THE HORNBLOWER OPINION ON VALUE OF NATIONAL'S WARRANTS WAS NOT MATERIAL.

(Reply to Respondent's Brief pp. 12-24 and SEC Brief pp. 20-21.)

Northway argues and the Court of Appeals held that the Proxy Statement:

(a) disclosed market prices of securities involved in the transaction, including National's warrants, quarterly and on November 7, 1969;

(b) stated the factors considered by Hornblower which included ". . . the substantial premium over current market values represented by the securities being offered to TSC stockholders.";

(c) did not disclose Hornblower's opinion of a $3.50 value for warrants, "subsequently rendered"; and

(d) was therefore false and misleading because TSC stockholders who relied on the Proxy Statement were led to believe the current market values disclosed therein were accurate indicators of the specific "profit" to be generated for them in the exchange, which was not true.[33]

Hornblower rendered a favorable opinion as to the fairness of the transaction to the stockholders of TSC. This fact and identification of five factors considered by Hornblower in reaching its opinion are spelled out on page 6 of the Proxy Statement (A. 267):

> "In such opinion, said firm considered, among other things, the current market prices of the securities of both corporations, the high redemption price of the National Series B preferred stock, the dividend and debt service requirements of both corporations, the substantial premium over current market values represented by the

33. 512 F. 2d at 334-335.

> securities being offered to TSC stockholders, and the increased dividend income."

Though fully aware that Hornblower considered many factors in reaching its favorable opinion on fairness of the transaction, the Seventh Circuit fastened on just one factor: A "substantial premium over current market values represented by the securities being offered to TSC stockholders."[34]

Next the court below strung a thin thread of inference from page 6 of the Proxy Statement, where the directors' approval, Hornblower's opinion, National equity interest in TSC and National's nominees on TSC's board are disclosed fully and fairly, to page 10 of the Proxy Statement, where the required disclosure of recent market prices of all securities of both corporations are set out along with the November 7, 1969 closing prices of the securities involved in the transaction.

With no visible means of support in the Proxy Statement, the court below nevertheless found that the Proxy Statement linked up the evaluation of the proposed exchange to the current market values shown in the table of market prices and "invited shareholders to rely on a table of market values. . . ." Then the court used its own "simple arithmetic" to determine the specific and substantial premium which it found the Proxy Statement invited shareholders to rely upon and which it characterized as the "profit" to be generated by the exchange being proposed.[35] The court also fostered the novel inference that the Proxy Statement led the shareholders to believe that Hornblower considered current market values disclosed in the proxy to be accurate indicators of the profit they would realize.

Having isolated one factor considered by the investment banking firm and linked it to a portion of a full page of market price information four pages later in the Proxy Statement, the court below concluded that a Hornblower opinion of a $3.50 intrinsic value of the warrants should have been disclosed.

34. 512 F. 2d at 334, n. 16.

35. 512 F. 2d at 335.

SEC also argues that the prices shown for National warrants in the table on page 10 were rendered materially misleading by the failure to disclose the $3.50 opinion on value of the warrants and comments (at page 21):

> "This data was materially misleading because it did not disclose that the Hemphill, Noyes firm had *subsequently* advised management that it expected that the market value of the National warrants included in the package would decline substantially subsequent to the proposed exchange." (Emphasis added)

Both the Seventh Circuit in writing its opinion (512 F. 2d at 335) and Northway in its argument in this Court foster and then rely upon two fictions. Each fiction readily disappears upon examination of the summary judgment record. *First,* Noyes' opinion on value (which is not the same as market price) was neither later or subsequent to, nor inconsistent with, the current market prices of all securities (including the warrants at 5⅜ in early October 1969) of which Noyes as an experienced investment banker, an important stockholder and director of TSC, was well aware. As noted herein at pp. 6-7, 27-28, his opinion of intrinsic value was used in negotiations with the representatives of National by Noyes himself in a series of meetings between October 2 and October 9, 1969 as a basis for raising the exchange ratio above that proposed by National in order to provide a premium over current market prices of the TSC securities.

Second, the rise in price of the TSC securities from mid-October to November 7, 1969 as a result of the favorable exchange ratio becoming public knowledge, which gave the marketplace an opportunity for arbitrage profits,[36] is wholly ignored by both the court below and Northway in making their calculations as to the premium afforded by the package of National securities

36. The key role which arbitrageurs play in price and volume of publicly traded securities on the moment of important news is well explained in "Ruthlessness by the Rules," FORBES, February 1, 1976, Vol. 117, No. 3 at pp. 24-25.

over corresponding TSC securities prices on November 7, 1969, a month after the exchange ratio was formulated and more than two and one-half weeks after the favorable exchange ratio had become public knowledge.

Noyes' $3.50 opinion on intrinsic value of the warrants was neither subsequent to his October 16th opinion and report to the TSC board on the fairness of the transaction to the TSC stockholders, nor inconsistent with the evaluation which Noyes and his firm had made of the entire transaction from the point of view of the shareholders of TSC, giving due regard to a variety of factors including the current market prices of the securities of both corporations.

Identification and isolation of these fictions explains why the calculations made by Northway (Br. pp. 12, 14) with respect to the disappearance of the "substantial premium" are erroneous. Northway's calculations begin with the second fiction noted above. Northway ignores the substantial rise in the price of TSC securities from the period when the exchange ratio was determined (October 9) to the November 7, 1969 date; namely, that TSC preferred moved up from $11 to $12 while TSC common increased from 11⅝ to 13¼. *Instead of being deprived of a promised profit, TSC shareholders had actually already realized in the market price of their securities*[37] *a portion of the premium over current values of which Noyes wrote and spoke before the Proxy Statement was mailed to them on November 12, 1969!*[38]

37. Many of the reasons for not requiring disclosure of an opinion on value of one of several securities involved in a transaction where there are current market prices available as to all of them for the entire relevant period are indicated in Petitioners' Brief at pages 37-39.

38. Compare the Court of Appeals statement that the Proxy Statement linked evaluation of the proposed exchange to current market values and "invited shareholders to rely on a table of market values . . .", 512 F. 2d at 334, with the District Judge's analysis of these aspects of the summary judgment record, 361 F. Supp. at 116, where he comments that there is no evidence in the record to support Northway's claim that the Hornblower firm relied on a $3.50

When Hornblower made both its analysis and evaluation of the fairness of the proposed transaction to TSC shareholders and its counterproposal of an improved exchange ratio to National's representatives, the "current market values" of which Hornblower spoke in its October 16, 1969 letter to the TSC board on fairness of the transaction were early October prices.[39] Necessarily, Hornblower looked to a market price on National Series B preferred at $16 (A. 160); later it closed higher on November 7, 1969 at $16⅝ (A. 271). In early October the market price for the TSC common stock was $11⅝ (A. 159); it closed higher on November 7, 1969 at $13¼. Hornblower worked with a market price for the TSC preferred stock of $11 (A. 160); later it closed higher on November 7, 1969 at $12.

Hornblower worked with two assumptions on National's warrants (A. 149-150, 156-157): (1) the warrants' price was $5⅜ on the public market in early October, 1969; and (2) the warrants (including 2.6 million to be issued in the exchange) were intrinsically worth $3.50 as of October 9, 1969 (A. 155-156). As an experienced investment banker, Noyes avoided forecasting any substantial future profit to TSC stockholders.[40] He knew only too well that whether any resultant premium to TSC shareholders on December 5, 1969 could fairly be described as "substantial" could only be determined at that later point in time long after the marketplace's early reaction to the proposed transaction.

In negotiations with National on behalf of TSC, Hornblower and TSC director Noyes at all times assumed a $3.50 intrinsic warrant value. It was on that assumption that the Hornblower

value of the warrant *and* that use of that figure results in a very small premium, rather than the substantial one claimed.

39. A. 427.

40. There was no prediction of future market values in the Proxy Statement. Such predictions are proscribed by Rule 14a-9 and would have drawn angry comment from SEC staff who reviewed the document. No such comment was made here.

firm influenced the exchange ratio in favor of TSC and concluded that the proposed transaction was fair to the TSC shareholders (A. 155-158, 413). At the same time Mr. Noyes stated that it was "inadvisable in the securities business to argue with market evaluation" and that we "never ignore it." (A. 156.)

The Premium Was There.

There actually was a substantial premium in the package of National securities offered to the TSC shareholders under the October 9, 1969 exchange ratio, using Noyes' $3.50 opinion on value of National's warrants and then-current market values for all other securities involved in the transaction. The presence of a 19% premium for TSC preferred stockholders and a 14% premium for TSC common stockholders as of October 9, 1969 is shown below:

Premium to TSC shareholders on October 9, 1969 using Noyes' $3.50 intrinsic value for warrants and current market values for all other securities.

As of October 9, 1969	TSC Preferred	TSC Common
National B Pfd (at 16)	$ 9.60 (.6 sh.)	$ 8.00 (.5 sh.)
National Warrant[41] (at 3.50)	3.50	5.25 (1½ war.)
Total	13.10	13.25
Less TSC Market (pfd. 11) (com. 11⅝)	11.00	11.63
Premium	2.10	1.62
Premium of package of National securities (warrant at $3.50 intrinsic value) over current market values of TSC securities on October 9, 1969, the day the exchange ratio was set, expressed as a percentage	19%	14%

41. Market price was $5-3/8.

If the October 9, 1969 market value of the National warrants, 5⅜, is used rather than the $3.50 intrinsic value, the bottom line of the above chart would read "36%" with respect to the TSC preferred and "38%" with respect to the TSC common.

Between October 9, 1969 and November 7, 1969 (the last date for which current market prices were shown in the Proxy Statement at page 10) the price of TSC preferred rose from $11 to $12 while TSC common rose from $11⅝ to $13¼, possibly because of arbitrage once the favorable exchange ratio became public knowledge.[42] Hence a portion of the premium over current market prices of the TSC securities as they existed on October 9 had already been realized before the Proxy Statement was mailed to the holders of TSC on November 12, 1969.

The Proxy Statement market prices table actually invited a shareholder to look at the high and low market prices by calendar quarters for the years 1967, 1968 and 1969 (through November 7, 1969) and gave closing prices for the securities directly involved in the transaction at November 7, 1969.[43] The table below shows what the Proxy Statement revealed to the TSC stockholder who studied page 10 (A. 271) and made his own arithmetic calculations.

42. In the same period of time prices of National securities involved in the transaction changed very little. National Series B preferred increased from $16 to $16-5/8 while National's warrants, which were the other part of the package, declined in market price from $5-3/8 to $5-1/4.

43. A. 271.

Premium to TSC shareholders on November 7, 1969 using then-current market values for all securities as reported at page 10 of Proxy Statement (A. 271).

As of November 7, 1969	TSC Preferred	TSC Common
National B Pfd. (at 16⅝)	$ 9.98 (.6 sh.)	$ 8.31 (.5 sh.)
National Warrant (at 5¼)	5.25	7.88 (1½ war.)
Total	15.23	16.19
Less TSC Market[44] (pfd. 12) (com. 13¼)	12.00	13.25
Premium	3.23	2.94
Premium of package of National securities over current market prices of TSC securities on November 7, 1969, expressed as a percentage	27%	22%

The federal securities laws do not and should not require a proxy statement to spell out underlying assumptions as to value, formulas for calculating intrinsic values or negotiating techniques the investment bankers used in evaluating the various factors considered in arriving at their opinion and advice to the TSC board that the terms of the proposed transaction were "fair and equitable" to the TSC shareholders (A. 427-428).

Noyes' statement to his fellow TSC directors that there might be "some decline in the price of the warrants" was coupled with his express recognition and description of other important factors, all of which led to his opinion that "the exchange offer is a fair one" (A. 413). This was a responsible professional opinion which remained unaltered and was reiterated even after

44. December 5, 1969 closing prices of securities exchanged in the transaction were:

National Series B Preferred: $12-1/4
National Warrants: $4.00
TSC Common: $11-3/8
TSC Series 1 Preferred: $11.00

issuance of the Proxy Statement (A. 429). The Seventh Circuit imprudently and erroneously characterized the Hornblower assumption of a $3.50 warrant value as "bad news" when, in fact, it was really no news at all!

If opinions on intrinsic value (as contrasted with market price) of securities must be spelled out in a proxy statement, what about all of the other unexpressed judgments which necessarily were made to arrive at an opinion in October on the fairness of a transaction to take place in December?[45] What about the Hornblower firm's assumptions and consideration of the market prices of the securities of "both corporations?" What about the "high" redemption price of the National preferred, part of the package appraised as a "sound value?" (A. 413) What about the dividend and debt service requirements of "both corporations?" What about the "increased dividend income?" (A. 267, 427-428) Should the federal courts require elaboration and amplification of the professional analysis of all of these kinds of factors in a proxy statement? Finally, under the yardstick of Rule 14a-9, which of all such unexpressed assumptions can be determined to be so important that its omission renders the Proxy Statement itself false or misleading in a material respect?

The summary judgment record discloses that the honest and correct opinion of the Hornblower firm at all relevant times was that the proposed transaction was fair to the TSC shareholders (A. 427-429). The court below discovered a prediction of "profit" to be generated in the transaction, though no such forecast of future price or profit can be found in the plain print of the document. In furtherance of its conclusion the court below refused to recognize either the purpose or plain meaning of Noyes' letter to National (A. 519). The Seventh Circuit improperly and unnecessarily drew a biased, unfavorable in-

45. If the assumption of a $3.50 value for the warrants must be spelled out in the Proxy Statement, presumably full disclosure would also require parallel disclosures of opinions on the value (not market price) of other securities in the transaction.

ference and concluded that the Hornblower firm's true opinion was different, important and wrongfully withheld from TSC's shareholders. 512 F. 2d at 335. That prejudicial choice among several reasonable inferences by a reviewing court on a summary judgment record is simply inexcusable.

There actually was a "substantial premium over current market values" for the TSC shareholders. Noyes' use of a $3.50 intrinsic value of the warrants in evaluating the October 9, 1969 exchange ratio built in a conservative margin to cushion the probable market price impact of 2.6 million additional warrants which were to be issued upon approval of the transaction two months later. Otherwise, the favorable exchange ratio might have been thrown out of balance. Only by skipping over Noyes' testimony and supplying to the Proxy Statement predictions by the Hornblower firm of future market prices, was the court below able to surmise and infer enough to conclude that Noyes' opinion to National on the value of the warrants had to be disclosed in order to avoid making the table of market prices on page 10 of the Proxy Statement misleading as a matter of law.

The only proper inference, if any, to be drawn should have been adverse to Northway as the moving party and in favor of National and TSC against whom the motion was brought. *Adickes* v. *S. H. Kress & Co.*, 398 U. S. 144 (1970). That reasonable and plausible inference was that the opinion stated in Noyes' letter of October 31, 1969 was wholly consistent with, supportive of, and therefore fairly disclosed by, the Hornblower firm's previously expressed opinion and advice to the TSC board that the terms of the proposed transaction were "fair."

IV.

OMISSION OF REFERENCE TO MADISON FUND'S PURCHASES OF NATIONAL SECURITIES AND THE METHOD OF DISCLOSING NATIONAL'S OWN PURCHASFS OF ITS COMMON STOCK WAS NOT MATERIAL.

(Reply to Respondent's Brief pp. 24-36 and SEC Brief pp. 17-20.)

Despite Northway's repeated innuendo and insinuation of a "Madison-National" relationship and frequent reference to common stock purchases by "Madison and National," there is no direct evidence of any stock price manipulation by anyone. In fact the record shows otherwise. SEC unfairly characterized Madison as a "closely allied mutual fund" (SEC Br. p. 7) which had purchased National's convertible debentures and common stock in the market. Plainly Madison was not an "affiliate" of National[46] and, under the circumstances, there was then and is now no specific item in the proxy rules which would have required disclosure of Madison's purchases of National's common stock and debentures, securities which were *not* involved in the transaction with TSC in 1969.[47]

Although there is no evidence in this summary judgment record that all or any of such purchases had any effect on the market prices of National's common stock or on the National securities that were exchanged for TSC's stock, SEC's lawyers speculate at page 10 of their Brief that Madison's purchases of National's common stock "*may* (emphasis added) have affected

46. An "affiliate" is defined in SEC Rule 12b-2(a) as:

"(a) *Affiliate* an 'affiliate' of, or a person 'affiliated' with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." 17 C. F. R. § 240.12b-2(a).

47. Nothing in Schedule A to Rule 14(a) requires any such disclosure of securities transactions by Madison Fund on the facts in this summary judgment record.

that data," *i.e.*, market prices of all National and TSC securities shown at page 10 of the Proxy Statement (A. 271). Then, apparently warming to the task of finding some Rule 14a-9 violations (no doubt to vindicate their Amicus Brief in the court below), the SEC Brief pontificates (at page 20):

> "In any event, there was not even minimal disclosure of the purchases by the Madison Fund or of the relationship between that fund and National. Although recent market prices of the company's securities were required to be disclosed by Schedule 14A of the proxy rules, 17 C.F.R. 240.14a-101, this did not justify the failure of management to disclose with equal prominence market transactions by National and Madison Fund which *necessarily affected these prices*." (Emphasis added)

SEC's comments are little else but rank speculation on what might have happened. They are neither supported nor inhibited by any evidentiary facts in the summary judgment record. The SEC's lawyers are not expert witnesses whose opinions on the mechanisms of the public securities markets can be added to the record in this Court.

The Seventh Circuit's analysis of the omission of facts relating to market purchases by National and Madison Fund is essentially identical to its analysis of the omissions relating to National's alleged control over the management of TSC. The court's analysis of the market purchases involves three steps. First, the court concedes that the question of market manipulation is still open. It makes no findings as to the existence of manipulation. Second, the court finds that on the basis of the facts, manipulation "is certainly suggested." Third, the court finds that Rule 14a-9 has been violated because the offerees "must be informed of circumstances which tend to indicate . . . market manipulations."[48]

The flaw in the Seventh Circuit's analysis is its belief that Rule 14a-9 requires disclosure of suggestive facts concerning manipulation and control without regard as to whether there

48. 512 F. 2d at 336, quoted herein at p. 15.

actually was manipulation or control. This proposition is clearly demonstrated in the court's discussion of manipulation where the court indicated that the purpose of Rule 14a-9 is to give stockholders facts on which they can speculate.[49]

The court's position that Rule 14a-9 requires disclosure of suggestive facts without regard as to the actual state of affairs represents a misunderstanding of the disclosure policies underlying the Rule. The defects in the lower court's interpretation of Rule 14a-9 are analyzed above at pages 14-16 of this Reply Brief.

Whether Madison Fund purchases of National common stock and convertible debentures (neither of which was involved in the proposed transaction) were somehow coordinated or in concert with National was sharply disputed by Opposing Affidavits; summary judgment treatment was thereby precluded under Rule 56. The District Court correctly recognized the importance of this.[50] The Seventh Circuit erred.[51]

As noted in our brief restatement of the decisive facts,[52] National's common stock was *not* involved in the transaction. TSC shareholders received principally National preferred stock and some National warrants. Moreover Northway does not even claim to have any evidence establishing, for purposes of its summary judgment motion, that the purchases of the mutual fund were coordinated with National.

Wholly speculative (SEC Brief p. 20) is the effect, if any, such common stock purchases may have had on the market price of National's common stock, which declined throughout 1969.[53] Notably absent too is any evidence of the effect of the

49. *Id.*, quoted herein at p. 15.

50. 361 F. Supp. at 115-116.

51. 512 F. 2d at 335-336. Contrast the analytical approach to summary judgment evidence and procedure taken by the District Court in 361 F. Supp. at 116 with the short shrift given Rule 56(c) and SEC Rule 14a-9 by the Seventh Circuit in 512 F. 2d at 336.

52. P. 8 of this Reply Brief.

53. A. 107-108 Graph.

market price of National's common on the price of National warrants which were to be issued in that transaction.

In these circumstances, Rule 14a-9 does not require disclosure of such purchases to enable stockholders to speculate as to the possible remote effect of such market transactions.

V.

UNEXPLAINED CONTRADICTION IN SEC's AMICUS POSITION.

(Replying to SEC Brief pp. 4-9, 17-24.)

SEC urged the court below to sustain some of Northway's claims on the motion for summary judgment and to reject others. Obviously impressed with the position of a government agency, the Seventh Circuit followed the suggestions of the SEC religiously: It rejected the allegations of control, which the SEC had said were not proved, and accepted as material those allegations, *e.g.*, the board titles of Yarmuth and Simonelli, which the SEC said had been proved sufficiently for summary judgment.

While the Seventh Circuit swallowed whole the SEC's recommendations, it recognized that in order to accept those recommendations it would have to apply lower standards of materiality than those which had been proclaimed by this Court and previously applied by other courts; this it was willing to do.[54]

SEC's suggestions, carrying with them the connotations of the impartial judgment of an expert body, were adopted in a manner not worthy of such construction. The SEC's argument was presented by those SEC lawyers having the least acquaintance with the field of disclosure, and with no knowledge of the processing of proxy statements including the present one.

The SEC's Briefs in the Seventh Circuit and in this Court set up some of the very same facts which the Division of

54. 512 F. 2d at 329-332.

Corporate Finance, four and a half years earlier, plainly did not consider to be sufficiently important to require disclosure. SEC's Division of Corporate Finance reviewed and "cleared" the Proxy Statement in the fall of 1969 without even suggesting the disclosure of any of the matters which counsel for SEC now regard as sufficiently material to make the Proxy Statement itself false and misleading.

The staff was obviously familiar with the prior filings stating that "National may be deemed to be a parent of TSC" and that Mr. Yarmuth was titular Chairman of the board of TSC. The Division's staff, however, in its letter of comment did not call for the disclosure of the prior filings or for any additional disclosures as to the potential National may have had for influencing the actions of the TSC board in recommending the approval of this transaction. Yet, SEC's Brief here makes a major point of the absence of any reference to the prior SEC filings.

This is very reminiscent of what happened in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281, 1291-1292 (2d Cir. 1973), where Judge Friendly said that positions taken by the SEC's Brief there "must have been as much a surprise to the Commission's branch chief [the Division of Corporate Finance official who reviewed the proxy statement there] . . . as it was to Skogmo's counsel." There is no explanation of why the SEC's Briefs take a viewpoint so diverse from that of the Division which has the primary responsibility for reviewing proxy statements and developing disclosure policies. The only clue offered in SEC's Brief (pages 23-24, n. 13) is that the staff was busy and was not aware of some of the facts. This may be true but it does not apply to the "may be deemed to be a parent" language which was before the staff in the current files. It is plain that the examiners in the Corporate Finance Division regarded the omission of reference to those prior required reports as appropriate when they reviewed the preliminary proxy statement.

The SEC's arguments as to whether the particular omissions made the Proxy Statement false and misleading should be entitled to little consideration. This Court observed recently that where there is an "unexplained contradiction in the Commission's position we accord no special weight to its views."[55] There is such an unexplained contradiction here between the action of the Division of Corporate Finance in "clearing" the Proxy Statement in 1969 and the SEC's Brief.

In this Court SEC's lawyers appear to reject the broader rule of materiality adopted by the Seventh Circuit but predictably repeat the same arguments as to the materiality of the omissions which were made in the Seventh Circuit. Despite what SEC's attorneys now feel free to say about materiality in their Brief (SEC Br. 13-16), the Commission itself in its comprehensive Release 34-11733[56] refers to the same SEC Rules Petitioners have cited (Pet. Br. 20-23) as pointing the way to a workable standard for determining "material information," namely: SEC Rules 405, 12b-2 and 14a-9(a). Indeed, the Release (40 Fed. Reg. 51659-60) says it well:

> "The weighing of these factors, among others, is the mechanism by which disclosure is rendered fair as well as full. In administering the disclosure process under the Securities Act and the Securities Exchange Act, the Commission has generally resolved these various competing considerations by requiring disclosure only of such information as the Commission believes is important to the reasonable investor—'material information.' 17 CFR 230.-450(1), 230.408, 240.12b-20, and 240.14a-9(a). This limitation is believed necessary in order to insure meaningful and useful disclosure documents of benefit to most investors without unreasonable costs to registrants and their shareholders."

55. *United Housing Foundation, Inc.* v. *Forman*, 421 U. S. 837, 858 n. 25 (1975).

56. File No. S7-593, Environmental and Social Disclosure, 40 Fed. Reg. 51656 (Nov. 6, 1975), which is the source for a significant part of Petitioners' Brief, pp. 18-24, subtitled: "Materiality is the Key in Disclosure Standards." This Release was issued on October 14, 1975.

In this Court SEC's lawyers doggedly replay the same tired tale they sold the Seventh Circuit. They ignore SEC's comprehensive October 1975 Release and leave litigants and proxy writers wondering whether SEC really has any position on materiality. Once again, there is this same frustrating "unexplained contradiction" between the current Release on materiality and the SEC's lawyers' rumblings.

In sum, the views of SEC's lawyers merit no consideration here.

CONCLUSION.

TSC and National respectfully urge that the decision and judgment of the Court of Appeals for the Seventh Circuit on liability of these Petitioners be reversed and that the judgment and Order of the United States District Court denying Respondent's motion for summary judgment as to liability of corporate defendants be reinstated.

Respectfully submitted,

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No. 74-1471

In the Supreme Court of the United States

OCTOBER TERM, 1975

TSC INDUSTRIES, INC., ET AL., PETITIONERS

v.

NORTHWAY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The petition presents this case as involving the standard by which the materiality of omissions from proxy solicitation materials are determined for the purposes of Section 14(a) of the Securities Ex-

change Act of 1934, 48 Stat. 895, 15 U.S.C. 78n(a), and Rule 14a-9 promulgated thereunder, 17 C.F.R. 240.14a-9.[1]

In *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 431, the Court defined the objectives of Section 14(a) as follows:

> The purpose of § 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation. The section stemmed from the congressional belief that "[f]air corporate suffrage is an important right

[1] Section 14(a) of the Act, provides:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title.

Rule 14a-9(a) provides:

> No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

> that should attach to every equity security bought on a public exchange." H.R. Rep. No. 1383, 73d Cong., 2d Sess., 13. It was intended to "control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which . . . [had] frustrated the free exercise of the voting rights of stockholders." *Id.*, at 14.

In accordance with the congressional mandate, the Commission has adopted proxy rules requiring that various items of information be set forth in solicitations for the votes of stockholders and has specifically provided in Rule 14a-9 that no proxy solicitation shall be made that "is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading * * *."

This Court articulated the test of materiality under the federal securities laws in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 384, and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-154. The courts of appeals, however, have questioned whether the test covers misstatements and omissions that "might" affect a reasonable shareholder's decision, or is confined to facts that "would" affect that decision. See, *infra*, pp. 12-13. Proper resolution of what is material is of direct and immediate concern to the Securities and Exchange Commission in the performance of its day-to-day responsibilities under the Act.

The standard of materiality under Section 14(a) and Rule 14a-9 must reflect the Act's purpose to protect investors by "resolving doubts in favor of

those the statute is designed to protect * * *" (*Mills* v. *Electric Auto-Lite Co.*, *supra*, 396 U.S. at 385) yet avoid any requirement that would clutter proxy statements with trivial information or facts unrelated to the interests protected by Section 14(a). *Id.* at 384. For the reasons set forth in this brief, the Commission believes that the appropriate standard, as enunciated in *Mills* v. *Electric Auto-Lite*, *supra*, is whether the misstatement or omission has a significant propensity to affect the judgment of a reasonable shareholder in the process of deciding how to vote. The Commission further believes that under any of the suggested tests the proxy statement involved in this case omitted facts without which it was materially misleading.

STATEMENT

This private damage action for alleged violations of Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(a), and Rule 14a-9, promulgated by the Commission thereunder, involves a corporate takeover of TSC Industries, Inc., by the petitioner, National Industries, Inc. The respondent, Northway, Inc., was a shareholder of TSC at the time of the relevant transactions and sued derivatively in TSC's behalf in the United States District Court for the Northern District of Illinois. The district court denied respondent's motion for partial summary judgment (Pet. App. A31-A45). The court of appeals reversed, holding that ~~Northway~~ NATIONAL and TSC had violated Section 14(a) and Rule 14a-9 as a matter of law, and remanded for further proceedings.

1. National's acquisition of TSC was accomplished in two steps. The first step was the purchase in early February 1969, in a private transaction, of all of the TSC equity securities owned by Charles E. Schmidt and members of his family and a family foundation.[2] As a result, National became the owner of approximately 33 percent of the equity securities of TSC (App. 267). National then placed five nominees on the ten-member TSC board of directors, including Stanley Yarmuth, National's president, and Charles Simonelli, its executive vice-president (App. 267-268). Yarmuth and Simonelli subsequently became, respectively, chairman of the TSC board and chairman of TSC's executive committee (App. 48).[3] Of the five other directors, four were TSC employees (App. 268) and hence subordinates of Yarmuth, TSC's new chief executive and also chief executive of National.

On February 14, 1969, National reported to the Commission that "National [had] acquired approximately 33% of the outstanding voting shares of TSC, Inc. Accordingly, National may be deemed to be a 'parent' of TSC as that term is defined in the Rules

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[2] The complaint also alleged violations of Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, and alleged that the Schmidt family were aiders and abettors. The latter claims were resolved below in favor of the Schmidt defendants. The issues presently before this Court are confined to the claims under Section 14(a) against the corporate defendants.

[3] This, in effect, made Yarmuth chief executive officer of TSC (App. 445).

and Regulations under the Securities Act of 1933"[4] (App. 473, 490). TSC made a similar statement in its annual report to the Commission on Form 10-K, filed on February 27, 1969 (App. 509).

With its nominees installed on the TSC board, National proceeded with efforts to acquire the remaining 67 percent of TSC stock, which was publicly held. National formulated a proposed merger of TSC into National, under which the former would be liquidated, and its assets sold to National in exchange for a package of National convertible preferred stock and warrants for the purchase of National common stock. The National securities were then to be distributed to TSC shareholders in dissolution (App. 268).

The TSC board of directors apparently approved the proposal on October 16, 1969 (App. 265). Eight of the ten members of the board were present; four voted in favor of the merger and four abstained (three National nominees and one of the original TSC directors whose stock already had been sold to National in a separate transaction) (Pet. App. A22).

On November 12, 1969, the TSC and National boards jointly issued a proxy statement soliciting approval of the transaction by the shareholders of both companies. The merger proposal was recommended to the TSC shareholders as being in their best interest

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[4] Rule 405, 17 C.F.R. 230.405, adopted pursuant to the Securities Act of 1933, defines a "parent" of a specified person as "an affiliate *controlling* such person directly, or indirectly through one or more intermediaries" (emphasis added).

by both TSC's board of directors and its management (App. 259-267).

On motion for partial summary judgment, respondent asserted, *inter alia*, that there were material misrepresentations and omissions in the proxy solicitation with respect to the following three subjects of interest to shareholders:

1) The proxy statement failed to disclose recent purchases by National and a closely allied mutual fund of National's common stock, when price quotations for the common were given in the proxy statement as an indication of the value of the National offer.

2) The proxy statement emphasized an opinion rendered by the investment banking firm of Hornblower & Weeks-Hemphill, Noyes as to the fairness of the National offer to TSC shareholders, but failed to disclose a subsequent report by Hornblower reflecting unfavorably upon the value of the National warrants which were part of the package offered to TSC shareholders.

3) The proxy statement failed to disclose the positions in TSC held by National's president and executive vice president, and the reports that National and TSC submitted to the Commission that National may be deemed a parent of TSC for purposes of the Securities Act of 1933. These omissions were claimed to vitiate the objectivity of the proxy statement's recommendation to TSC shareholders that they approve the merger.

These omissions were alleged to be violations by TSC and National ("the corporate defendants") of Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(a), and Rules 14a-3 and 14a-9 promulgated thereunder, 17 C.F.R. 240.14a-3 and 17 C.F.R. 240.14a-9.

2. The district court denied respondent's motion for summary judgment on the question of liability of the corporate defendants (Pet. App. A31-A45). It held that the test of materiality of the omissions was whether "the facts withheld were so obviously important to TSC shareholders that reasonable minds could not differ on the question of whether the shareholders might have considered them important" (Pet. App. A34, A38), but concluded that on the record as it stood, a trial was required to determine materiality.

On an interlocutory appeal, the court of appeals reversed the district court's denial of summary judgment on the liability of the corporate defendants. It held material under Rule 14a-9 the undisputed fact that the proxy statement failed adequately to disclose (1) the existing relationship of National and TSC, (2) the purchases of National's common stock by National and the allied fund, and (3) the qualification of the earlier opinion rendered by Hornblower & Weeks-Hemphill, Noyes with respect to the fairness of the exchange offer to the TSC shareholders. Since reasonable minds could not differ as to the question of materiality, it concluded that plaintiff was entitled to summary judgment (Pet. App. A7).

The court of appeals held, on the basis of *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 384-385, and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-154, that "the proper test of materiality is whether the omitted fact is 'of such a character that it might have been considered important by a reasonable shareholder who was in the process of determining how to vote' " (Pet. App. A11-A12). It rejected a standard of materiality based upon whether the omitted fact could have " 'a significant *propensity* to affect the voting process,' " on the ground that "any test which does not require the inclusion of facts which *could* influence a reasonable stockholder would seriously undercut the intended prophylactic effect of these disclosure provisions" (Pet. App. A8, A9; emphasis in original). The court stated that "any test of materiality which requires a finding of some probability that the omitted fact would affect the voting process necessitates the same difficult proofs the Supreme Court sought to avoid [in *Mills* and *Affiliated Ute*, *supra*] by eliminating the need for independent proof of causation or reliance" (Pet. App. A10).

SUMMARY OF ARGUMENT

The Securities and Exchange Commission is of the view that the omissions from the proxy solicitation involved in this case are material under any of the interpretations by the lower courts of the standard of materiality declared in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 384-385, and reiterated in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-154. It does not believe that the *Mills* opinion formulated

two different tests of materiality. Rather, under *Mills*, the criterion is whether the omitted facts have a significant propensity to affect the judgment of a reasonable shareholder in deciding how to vote. Under this standard, when material affirmative statements have been made, additional facts which qualify or undermine those statements must also be disclosed in order to insure that the affirmative statements are not misleading. The more stringent test suggested by the petitioner is unsuitable because it would deny the federal securities laws the flexibility that is essential for the proper protection of investors.

In this case, the affirmative statements concerning the value of National's stock and warrants, the role of National's officials on TSC's board of directors, and the control relationship between the two firms, were unquestionably material to the shareholders' decision whether to vote for the merger. The facts omitted were, therefore, also material because they were necessary to make the statements in the proxy solicitation not false or misleading.

Since the proxy statement set forth market price data for National's common stock and warrants, it should have disclosed facts about purchases of that stock by National and an allied mutual fund, which may have affected that data. Similarly, since the proxy statement emphasized an investment banker's opinion concerning the prices of the National warrants, it should also have disclosed the banker's subsequent advice that the market value of those warrants was expected to decline subsequent to the pro-

posed exchanges. Finally, the proxy statement did not adequately disclose the relationship between the management of TSC and National so that the stockholders could assess the objectivity of the strong recommendation which had been made by TSC's management and board of directors that the merger be approved.

Any one of these omissions provided a basis for liability as a matter of law. And certainly their total impact established materiality as a matter of law.

ARGUMENT

I

AN OMISSION OF FACTS IN A PROXY STATEMENT IS MATERIAL IF IT HAS A SIGNIFICANT PROPENSITY TO AFFECT THE JUDGMENT OF A REASONABLE SHAREHOLDER IN DECIDING HOW TO VOTE

In *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 384-385, the Court held that proof that a misstatement or omission in a proxy statement is "material" is enough to establish a cause of action for violation of Section 14(a) of the Securities Exchange Act of 1934, and that there is no requirement of "proof of whether the defect actually had a decisive effect on the voting." The standard of materiality itself, the Court stated [*id.* at 384, emphasis in original]:

> embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote.

> This requirement that the defect have a significant *propensity* to effect the voting process is found in the express terms of Rule 14a-9, and it adequately serves the purpose of ensuring that a cause of action cannot be established by proof of a defect so trivial, or so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by § 14(a).

Two years later, in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, a case involving a suit for damages for alleged violations of the anti-fraud provisions of the Securities Exchange Act of 1934 growing out of failure to disclose certain facts in connection with the purchase of securities, the Court held that the plaintiffs were not required to prove that they had relied on the omissions. Citing the page of *Mills* containing the statement quoted above, the Court said that "positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. * * * This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact" (406 U.S. at 153-154).

The courts of appeals, however, have divided over whether the proper standard for determining materiality is whether the facts involved "would" or "might be" considered important by a stockholder. See *Smallwood* v. *Pearl Brewing Co.*, 489 F.2d 579

(C.A. 5), and *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (C.A. 2); see also the cases reviewed at Pet. App. A10, n. 13. In the present case the court of appeals concluded that the "might have" and "significant propensity" language in *Mills* constitute different standards from which different conclusions regarding materiality may result (Pet. App. A8-A9).

The Commission is of the view that the omissions involved in this case are material under any interpretation of *Mills* by the lower courts. ~~It also agrees with the court of appeals that the omissions involved in this case are material under the *Mills* standard~~. It sees no basis, however, for concluding that the *Mills* opinion formulated two different tests of materiality in the same paragraph.

To the contrary, it believes that *Mills* announced the following criterion for determining when facts omitted from a proxy statement are material: whether the omitted facts have a significant propensity to affect the judgment of a reasonable shareholder in deciding how to vote. We submit that this standard properly effectuates the purpose of Section 14(a) of the Act, and of the Commission's proxy rules, to ensure that shareholders have made available to them by management all the information that, in the circumstances of the particular case, they need in order to make an informed judgment on the proposal before them.

The more stringent test petitioners urge (Br. 24-27) is a reversion to the criterion for "materiality"

applied in actions for common law deceit. According to the ALI, *Restatement of the Law of Torts* § 538(2)(a) (1938), in such an action a fact is material if "its existence or nonexistence is a matter to which a reasonable man would attach importance in determining his choice of action in the transaction in question * * *."[5] Several courts of appeals have applied this common law standard to actions under Section 14(a) and Rule 14a-9. See, *e.g.*, *Gerstle* v. *Gamble-Skogmo, Inc.*, *supra*, 478 F.2d at 1301-1302; *List* v. *Fashion Park, Inc.*, 340 F.2d 457, 462 (C.A. 2); *Smallwood* v. *Pearl Brewing Co.*, *supra*, 489 F.2d at 604; *John R. Lewis Inc.* v. *Newman*, 446 F.2d 800, 804 (C.A. 5).

Whether or not those cases may have reached the correct results, the use of the common law tort standard is inconsistent with both *Mills* and *Affiliated Ute*. The federal securities laws are not limited to the standards of common law fraud and deceit; they are to be construed "not technically and restrictively, but flexibly to effectuate [their] remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U.S. 180, 195. See *Affiliated Ute*, *supra*, 406 U.S. at 151; *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12. Just as any imposition of the common law standard of reliance was deemed to be inconsistent with the pur-

[5] The Court in *Mills* was fully familiar with § 538(2)(a), and decisions applying it in securities cases. 396 U.S. at 384, n. 6. Nevertheless, it expressly adopted the less restrictive formula.

poses of the federal securities laws in *Mills* and *Affiliated Ute*, the adoption in this case of the restrictive definition of materiality embodied in the *Restatement* would deny the federal securities laws the flexibility that is essential for the proper protection of investors.

The *Mills* standard that an omission of facts is material if it has a significant propensity to affect the judgment of a reasonable shareholder in deciding how to vote effectuates the congressional policy reflected in Section 14(a) that shareholders of publicly held corporations should receive all information they need in order properly to exercise their rights of corporate sufferage. The standard strikes the necessary balance contemplated by Congress between two competing considerations: (1) the need to insure that corporate management take adequate steps to communicate to the shareholders information relevant to the stockholders' exercise of their voting rights, which it uniquely possesses; and (2) the need to avoid furnishing large quantities of trivial information because of concern over possible liability resulting from failure to disclose all facts necessary to make the proxy solicitations not misleading.

Petitioners contend (Br. 20-21), however, that because the definition of "material" in the rule governing information that must be furnished in a registration statement[6] and in a rule governing other

[6] Rule 405(l) under the Securities Act of 1933, 17 C.F.R. 230.405(l). See, also, Rule 408, 17 C.F.R. 230.408.

filings under the Securities Exchange Act of 1934[7] is similar to that in Rule 14a-9, the standard of materiality we here urge would greatly expand the quantity and type of information required to be furnished in those other documents. The provisions to which petitioner refers, however, are qualified by requirements for disclosure of additional facts necessary to make admittedly material facts affirmatively disclosed not misleading.[8] The application of the Commission's test of materiality to this narrow but important category of information would not substantially increase the amount of information required in either registration statements or other filings or disclosures under the Securities Exchange Act of 1934. It would require only that where certain material affirmative statements have been made, additional facts which qualify or undermine those statements must also be disclosed in order to insure that the affirmative statements are not misleading.

The affirmative statements in the proxy solicitation concerning the value of National's stock and warrants that were being offered to TSC's shareholders in the merger, the role of National's officials on TSC's board of directors and the ~~stock~~ CONTROL relationship between the two firms, were unquestionably material to the shareholders of the two companies in deciding whether to vote for the merger. As we now

[7] Rule 12b-2(j) under the Securities and Exchange Act of 1934, 17 C.F.R. 240.12b-2(j). See, also, Rule 12b-20, 17 C.F.R. 240.12b-20.

[8] See n. 7, *supra*.

show, the facts omitted from the proxy statement were equally material because they were necessary to make the statements in the proxy solicitation not false or misleading.[9]

II

THE OMISSIONS IN THE PROXY STATEMENT WERE MATERIAL

A. The Proxy Statement Did Not Disclose Important Facts Concerning the Value of the National Securities Offered to the TSC Shareholders

1. The proxy statement represented that in approving the proposed merger, TSC's board of directors had considered recent market prices of the

[9] The factual setting in *Mills* was similar to the case at bar. The transaction for which shareholder approval was there sought was a merger of Electric Auto-Lite into Mergenthaler Linotype Company. The Auto-Lite directors recommended approval of the merger to shareholders without adequately disclosing the relationships of the Auto-Lite board and management to Mergenthaler, the acquiring corporation, and to American Manufacturing Company, which was apparently in control of both Auto-Lite and Mergenthaler. Even though "the proxy statement contain[ed] information which would indicate to those aware of corporate mechanism that Mergenthaler had the power to select a majority, if not all, the members of the board * * *," *Mills* v. *Electric Auto-Lite*, 403 F. 2d 429, 433 (C.A. 7), the proxy statement was held to violate Section 14(a) because the control relationships were not presented with as great emphasis as was given to the favorable recommendation of the board. *Id.* at p. 433. The *Mills* proxy statement had omitted to disclose that in connection with an application for exemption from the Investment Company Act of 1940, officials of American Manufacturing Company had represented that that company controlled the operation of both Mergenthaler and Auto-Lite.

tendered securities (App. 267). It also set forth market price data concerning National's common stock for the years 1967-1969 as well as for warrants to purchase that stock (App. 271). Management stated that it considered this market price data in recommending the merger (App. 267).

The proxy solicitation materials omitted to disclose, however, that purchases of National's common stock by National and by the Madison Fund, Inc., a mutual fund, together comprised 8.5 percent of the total volume of all transactions in that security on the New York Stock Exchange during the nine-month period between National's initial purchase of TSC stock from the Schmidt family and the proxy solicitation (App. 544-547).[10] The chairman of National's board of directors was also a Madison Fund director, and Edward Merkle, Madison's president—who caused Madison to purchase National's securities—was employed by National as a "consultant" at $12,000 per year (Pet. App. A18-A19 nn. 21, 22; App. 522).

These purchases and the relationships should have been disclosed so that the TSC stockholders could judge the extent to which the market prices empha-

[10] In eleven of the weeks in which the purchases were made, they exceeded 10 percent of the total volume and in one week during the period these purchases were 66 percent of the total volume (App. 544-547).

sized in the proxy material may have reflected something other than normal supply and demand.[11]

Accordingly, as the court of appeals held, it was not necessary to prove that there was collusion between National and the Madison Fund to manipulate the market in National's common stock in order to establish the materiality of these facts. The court of appeals correctly stated (Pet. App. A19):

> It was for the shareholders to determine whether the market price of the common shares was relevant to their evaluation of the convertible preferred shares and warrants, or whether the activities of Madison and National actually amounted to manipulation at all. This is the very purpose of disclosure.

While some figures, set forth in small type, concerning the cost of "shares of Common Stock purchased for treasury" could have been gleaned from a table entitled "Statements of Consolidated Stockholders' Equity," on pages 62-63 of the proxy statement (App. 323-324), these did not show when the purchases were made, other than that they occurred within a three and one-half year period. They were not comparable in prominence to the section entitled "Market Prices of Securities," appearing on page 10

[11] On July 19, 1972, the Commission suspended Mr. Merkle, Madison's president, from association with any broker-dealer for sixty days, based, in part, upon his having caused Madison Fund to purchase National securities without disclosing his salaried position with the company. See Securities and Exchange Commission Investment Company Act Release No. 7280 (1972) (App. 563).

(App. 271). Even a sophisticated investor who understood that this table reflected purchases by National of its own stock and who might have realized that the "treasury" purchases were in some way related to the market prices set forth at page 10, could not have made a proper analysis because the figures for treasury purchases were not broken down into 3-month periods as were the figures on page 10.

In any event, there was not even minimal disclosure of the purchases by the Madison Fund or of the relationship between that fund and National. Although recent market prices of the company's securities were required to be disclosed by Schedule 14A of the proxy rules, 17 C.F.R. 240.14a-101, this did not justify the failure of management to disclose with equal prominence market transactions by National and Madison Fund which necessarily affected these prices.

2. The value of the package of National securities offered to TSC shareholders was further distorted in the proxy statement by a misleading presentation of an opinion rendered by the investment banking firm of Hornblower & Weeks-Hemphill, Noyes. The proxy statement reported that (App. 267):

> At the request of TSC, the investment banking firm * * * rendered a favorable opinion as to the fairness to the stockholders of TSC of the terms, set forth below, * * *. * * * In such opinion, said firm considered, among other things, the current market prices of the securities of both corporations * * * [and] the substantial premium

> over current market values represented by the securities being offered to TSC stockholders * * *.

As we have noted, the statement prominently set forth recent market prices. These included the prices of the National warrants.

This data was materially misleading because it did not disclose that the Hemphill, Noyes firm had subsequently advised management that it expected that the market value of the National warrants included in the package would decline substantially subsequent to the proposed exchange. As the court of appeals noted, "TSC and National had received some good news and some bad news from the Hornblower firm. They chose to publish the good news and omit the bad news" (Pet. App. A17). These materially misleading representations are precisely the type of unfair corporate communication against which the proxy rules are intended to protect shareholders.

B. The Proxy Statement Did Not Adequately Disclose the Relationships Between the Management of the Companies that Showed the Influence of National Upon TSC's Management

TSC's management, which had a fiduciary relationship to its shareholders, could not properly advise its shareholders to approve the merger without also revealing the facts showing the influence of National upon TSC's management. Where a proposed corporate transaction involves dealing with an outside entity, as in a proposed sale of the corporate assets or a merger, any existing relationship between that

entity and the corporation that is likely to influence the latter's attitude toward the transaction is highly significant to shareholders asked to approve the proposals. For shareholders are entitled to assume that the recommendation of their board of directors is objective. It is therefore misleading when, as here (App. 259), the management and board of directors of a company make a strong recommendation to its stockholders, who are deciding how to exercise their corporate suffrage, without disclosing to the stockholders the interest of those making the recommendation.

To be sure, the proxy materials issued in connection with the National acquisition disclosed that five of the directors of TSC were nominees of National (App. 267-268), and that National owned a 33 percent equity interest in TSC (*ibid.*). Adequate disclosure must be such, however, that an ordinary investor, not merely a sophisticate, may understand the truth.[12] Whether or not National actually controlled TSC at the time of the proxy solicitation, shareholders were entitled to know that the two companies had previously told the Commission that "Na-

[12] *Surowitz* v. *Hilton Hotels Corp.*, 342 F. 2d 596, 602 (C.A. 7), reversed on other grounds, 383 U.S. 363; *United States* v. *Monjar*, 47 F. Supp. 421, 425 (D. Del.), affirmed, 147 F. 2d 916 (C.A. 3), certiorari denied, 325 U.S. 859. The Commission has for many years applied this principle in its administrative decisions. See *In the Matter of Axe Securities Corporation*, 42 S.E.C. 381, 383; *In the Matter of The Private Investment Fund for Governmental Personnel, Inc.*, 37 S.E.C. 484, 487; *In the Matter of Universal Camera Corp.*, 19 S.E.C. 648.

tional may be deemed to be a 'parent' of TSC" in accordance with Commission rules that define "parent" in terms of "control" (App. 473, 490, 509, 512, 517), so that they could assess the significance of that relationship as the corporations themselves understood it.[13]

Moreover, the significance of National's influence would further have been emphasized by disclosure of the facts that National's president is chairman of TSC's board of directors and that National's executive vice-president is chairman of TSC's executive committee—facts which were not set forth in the proxy statement.

Accordingly, without these disclosures, the purportedly objective recommendation of management was materially misleading.[14]

[13] Resolution of the issue of adequate disclosure of the relationship between National and TSC does not turn, as petitioners suggest (Br. 6), upon an affirmative factual determination that, at the time the proxy statement was issued, National was or was not in control of TSC. The court of appeals recognized that the disclosure problem presented here with respect to control relationship is different.

> We agree with the district court that the issue of control is a factual issue presently in dispute and that summary judgment as to the Rule 14a-3 claim would have been inappropriate. * * *
>
> Plaintiff's Rule 14a-9 motion for summary judgment is quite different * * *. [Pet. App. A6.]

[14] Petitioner seems to suggest (Br. 28-29) that the disclosure in the proxy solicitation materials should be deemed adequate because prior to dissemination to stockholders, these materials were submitted to the staff of the Commission for

While liability can be predicated on any one of the foregoing omissions, there can be no question that their total impact bears significantly on the purported objectivity of the advice that the TSC management gave its stockholders that the merger was in their best interest. Accordingly, and without reaching disputed facts such as the existence of actual collusion in the market purchases or actual control of TSC by National, the court of appeals correctly determined that the omissions were material as a matter of law.

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comment. Of course, certain of the omitted facts could not have been known to the Commission's staff when it reviewed the proxy materials. In any event the Commission's Rule 14a-9(b), 17 C.F.R. 240.14a-9(b) provides:

> The fact that a proxy statement * * * has been filed with or examined by the Commission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein * * *.

See *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432: "The Commission advises that it examines over 2,000 proxy statements annually and each of them must necessarily be expedited." In the Commission's fiscal year 1970, when the TSC solicitation took place, 5,595 proxy statements were submitted for review by the Commission's limited staff. See, Thirty-Sixth Annual Report of the Securities and Exchange Commission, p. 46 (1970).

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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1968 1969 1970

NII COMMON STOCK

NII PREFERRED STOCK
$1.25 SERIES B

NII WARRANTS

* COMMON STOCK TRADED ON AMEX FROM JAN. 1968 - JULY 1968. ** JULY 2, 1968 NII LISTED ON NYSE.

JANUARY 1968 FEBRUARY MARCH APRIL MAY JUNE JULY AUGUST SEPTEMBER OCTOBER NOVEMBER DECEMBER JANUARY 1969 FEBRUARY MARCH APRIL MAY JUNE JULY AUGUST SEPTEMBER OCTOBER NOVEMBER DECEMBER JANUARY 1970 FEBRUARY MARCH APRIL MAY JUNE JULY AUGUST SEPTEMBER OCTOBER NOVEMBER DECEMBER

TOTAL NUMBER OF NII COMMON STOCK TRADED

TOTAL NUMBER OF NII COMMON STOCK PURCHASED BY MADISON FUND

TOTAL NUMBER OF NII COMMON STOCK PURCHASED BY NII

557,600 268,500 194,900 442,900 512,700 317,900 287,800 150,500 196,100 313,700 418,500 484,500 316,500 176,600 150,300 168,600 206,200 153,900 149,300 138,700 184,400 226,300 178,600 272,700 128,200 73,700 71,900 91,200 117,900 78,500 59,300 57,900 113,900 57,600 66,300 167,900

2

1968
Madison Fund Purchases
as Percent of Weekly Volume

1969
Madison and National Purchases
as Percent of Weekly Volume

Purchases as Percent of Weekly Volume

Purchases as Percent of Weekly Volume

NII COMMON STOCK

NII PREFERRED STOCK $1.25 SERIES B

NII WARRANTS

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS

NORTHWAY, INC.)
v.) No. 69 C 2513
TSC INDUSTRIES, INC.)

EXHIBIT A TO REPLY BRIEF OF PLAINTIFF
IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT
AS TO LIABILITY OF CORPORATE DEFENDANTS

Note: Chart underneath transparent plastic is Exhibit to Brief of Corporate Defendants. Overlay is based on Charts A and B and Notes thereto attached to Plaintiff's Main Brief.

Upper Portion: Bar Chart shows Madison and National Purchases as Percent of Weekly Volume (BLUE LINES)

Lower Portion: Significant Events. (Letters in parentheses refer to Notes to Charts A and B) (RED LINES)

(A) 1-20 NII purchases Susskind's stock at price over market

(B) 1-30 NII deal to acquire Schmidt stock

(C) 2-3 NII acquires option on Crescent stock

(D) 2-22 Initial Madison Fund purchase of NII Common

(E) 3-25 Crescent votes to merge with NII

(F) 4-22 NII proposes merger of NII and Cott

(G) 4-25 NII Crescent Proxy Statement mailed

(H) 5-3 & 5-10 Valuation period of NII Common for Crescent transaction. Madison buys heavily. NII Common rises sharply.

(I) 5-17 to 6-18 Madison continues purchases of NII Common. 6-20 Crescent and Cott stockholders approve merger.

(J) 7-5 NII acquires 53% of Hawthorn-Mellody

(K) 9-3 NII proposes merger with Hawthorn-Mellody

(L) 9-20 & 9-27 Valuation period of NII Common for Hawthorne-Mellody transaction. Madison makes substantial purchases of NII Common.

(M) 10-1 Hawthorn-Mellody Proxy Statement mailed

(N) 10-1 NII raises salary of Merkle, President of Madison

(O) 10-3 NII offers convertible debentures. Madison buys $2,000,000 of debentures.

(P) 10-13 Acquisition plan publicly announced. 10-16 TSC directors purport to approve plan.

(Q) 10-7 Newspaper reports of NII acquisition of TSC. Madison buys NII Common preceding and following announcement.

(R) 8-25 to 8-29 Valuation period for NII Common re Nelson Sales deal. NII buys NII Common. Price rises.

(S) 8-15 NII reports poor first half results. On 8-11 NII buys 2,800 shares of NII Common.

(T) 6-26 NII buys NII Common over market

(U) 6-18 Hawthorn-Mellody Retirement Fund buys NII Common

(V) 5-16 NII reports poor first quarter earnings. On 5-15 NII buys NII Common.

(W) 4-7 NII Common falls to 1969 low. Madison buys NII Common throughout week.

(X) W/E 3-28 NII buys NII Common over market